92-994 (1)

Supreme Court, U.S.
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No. __________

In the

Supreme Court of the United States

October Term 1992

JOHN H. WHITEHOUSE and
CAROL A. WHITEHOUSE,
Petitioners,

vs.

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

JOHN H. WHITEHOUSE

CAROL A. WHITEHOUSE
Petitioners, Pro Se

1030 Treasure Lane
Vero Beach, Florida 32963
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259 pp

QUESTION PRESENTED FOR REVIEW

Whether or not a husband and wife team, working together in a small business, established as a Massachusetts Business Trust can be classified as an "association" and, therefore, taxable as a corporation under IRC Section 7701(3) where the wife testified that the husband controlled and managed the business decisions, but that she carried out the support functions such as bookkeeping, testing of products and typing, and whether the Second Circuit's affirmation of the Tax Court decision is in direct conflict with this Court's decision in *Morrissey et al., v. Commissioner*, 296 U.S. 344 (1935), stating that lack of management voice or control should not be considered in determining whether a Massachusetts Business Trust should be classified as an association.

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REPORT OF OTHER COURTS

This petition is from a Summary Order of the United States Court of Appeals for the Second Circuit, Number 92-4080 filed July 24, 1992, which Summary Order affirmed a decision of the United States Tax Court, unofficially reported at Tax Ct. Mem. Dec. (P-H) Paragraph 91,104 (1991).

JURISDICTION OF THIS COURT

This Court has jurisdiction under Title 28, Section 1254(1) in that it seeks review of a Summary Order of the Second Circuit Court of Appeals by way of Petition for Writ of Certiorari. The Court also has jurisdiction under Supreme Court Rule 13.1 in that the date of the Second Circuit Court of Appeals judgment is July 24, 1992, within ninety days of

the date of filing of this Petition.

STATUTE INVOLVED

IRC Section 7701(3) CORPORATION - The term "corporation" includes associations, joint-stock companies, and insurance companies.

STATEMENT OF THE CASE

A. Federal Jurisdiction:

The United States Tax Court acquired jurisdiction by the timely filing of a Petition on behalf of Petitioners seeking review of a Notice of Deficiency issued to Petitioners on April 6, 1983 for the tax years 1979 and 1980.

The Court of Appeals had jurisdiction pursuant to IRC Section 7482 from a final decision of the Tax Court against Petitioners in the amount of $80,838.00

for the tax years 1979 and 1980, combined. Petitioners filed their Notice of Appeal from that decision on December 2, 1991.

B. Facts Material to Question Presented

John and Carol Whitehouse were a husband and wife team operating a small business. John Whitehouse was an inventor and his wife, Carol, was a technical person providing technical, operational and clerical support in their business.

Approximately twelve years ago John and Carol formed a Massachusetts Business Trust to promote the distribution of one of their products, a water-saving toilet known as the "Meditator". They filed separate tax returns for the trust, wholly apart from their individual returns. The question presented for review is whether or not that separate tax return can stand or whether taxes should fall back on John

and Carol personally. If the trust can qualify as an "association" under IRC it can be taxed as a corporation, the separate tax return can stand, and the Petitioners will not have personal liability. It is undisputed that the question of whether the trust can qualify as an "association" depends entirely on Carol qualifying as an "associate" under applicable case law. Whether or not she is an associate depends in turn on what role she played in the business enterprise. Whether her role qualifies her as an associate is the only question raised by the Petition, and the Courts below absolutely defied this Court's clear prior decision on this subject.

In the testimony at trial, Carol admitted that she had no management voice or control in the enterprise, but she also testified that she participated in the

enterprise in the following ways:

1. She personally did the testing of the output water pressure of the device and evaluated whether it would comply with local plumbing codes and retrofit in homes having existing equipment (Tr. 195).

2. She worked with accounting information (Tr. 196).

3. She took minutes of meetings (Tr. 197-198).

4. She did the bookkeeping (Tr. 196).

5. She was the typist (Tr. 198).

6. She showed the Florida manufacturing site to distributors (Tr. 250).

7. She helped her husband work on building designs and code approvals (Tr. 174).

The question is whether these activities entitle her to be characterized

as an "associate" even though she turned over the management voice and control to her husband under the format of a Massachusetts Business Trust. In many ways, this is the opposite of a feminist rights issue; it involves the right of a woman who provides support functions for her manager husband in a trust business enterprise to be recognized as an "active participant" and therefore an "associate" under the Internal Revenue Code. One could easily view the Court's failure to recognize Carol's support role as significant enough to rise to the level of "associate" as being a consequence of a male oriented business society that diminishes the importance of a woman's support functions and overrates management and control as being the only essential elements of active participation in a business enterprise.

Ironically enough, the Tax Court decision, correctly stated that the Supreme Court in *Morrissey, supra* ruled that a trust could be classified as an association even if the beneficiaries do not have management voice or control. However, that Court then went on to quote two subsequent Tax Court decisions, *Elm Street Realty Trust v. Commissioner,* 76 T.C. 803 and *Bedell Trust v. Commissioner,* 86 U.S. Tax Court 1207, to the effect that for Carol to be an associate, she must be an "active participant". From this point on, the Court's logic went sideways. In determining whether she was an active participant, the Court characterized Carol's role as follows: "Carol's role in WRC's operations was to keep the books for WRC." The Court was silent as to Carol's other roles listed on the previous page of this Petition, but it emphasized her lack

<u>of management voice.</u> Specifically, the Court quoted Carol's testimony[1] as follows:

> "At trial, Carol put it this way:
>
> > `Q. (Izen) Who made the decisions? Who had the final say so with what was going to be done with the property of Water Resource Control and the assignment rights that it had in the toilet?
> >
> > A. John Whitehouse.
> >
> > Q. All right. Did you have any sort of input in the decisions that were made, business-wise?
> >
> > A. No.
> >
> > Q. Did Mr. Whitehouse consult you before they were made in any decisions?
> >
> > A. Did he consult me about business decisions?
> >
> > Q. Yes. The decisions --
> >
> > A. No he made his own

---

[1] To show how significant this quote was, we point out that it was the only quotation made in the Court's forty-nine page opinion.

> business decisions. He's been doing that for a long time.'
>
> "Accordingly, we conclude that Carol did not participate actively in WRC's creation or conduct."

It seems then that the Tax Court, while initially recognizing that *Morrissey* ruled out "management voice or control" as a factor, became enmeshed in the definition of "active participation" found in the above two Tax Court decisions. It went on to conclude that Carol was not an "associate" because she was not an "active participant" and that she was not an active participant because she did not have management voice or control, coming right back to the very prohibition of *Morrissey*. In other words, the Tax Court reached a conclusion which was directly in conflict with its starting premise, namely that *Morrissey* ruled out control or

management voice as a factor in determining whether a trust should be treated as an association and taxable as a corporation.

While *Morrissey* is more than fifty years old, it is the last word rendered by this Court as to how and why a business trust can qualify as an association. The current Tax Court's decision flew directly into the face of *Morrissey* and represents an outstanding conflict which needs to be resolved by this Court. The subliminal question of whether or not a woman working with her husband in a small business venture, doing bookkeeping, typing, testing and other support functions, can qualify as an associate is an important one in today's times. In other words, are these support functions important enough to qualify her as a business partner with her husband. Does a woman have to have

control or management voice to be recognized as an active participant or can a hard working woman who supports her husband in their joint enterprise on a full time basis qualify as an "active participant" also?

ARGUMENT

The lower Court's decision that the Petitioner's trust cannot qualify as an "association" flies directly in the face of the Supreme Court decision in *Morrissey*. That case involved evaluation of a Massachusetts Business Trust, which is the same kind of trust in this case. *Morrissey* is, in effect, a thesis on the meaning of the word "association". That case and the prior Supreme Court cases leading up to it resulted from the Internal Revenue Service attempts to collect corporate excise taxes on business

trusts. The IRS was specifically seeking out business trusts and attempting to classify them as "associations" and hence qualify them as "corporations" so that they could collect corporate excise taxes. The business trusts were resisting being declared an "association" so that they could escape the excise tax. In each case, the government won, and this Supreme Court ruled that the Massachusetts Business Trusts qualified as "associations" and hence were subject to the corporate taxes.

While the trusts lawyers used every angle to attempt to distinguish their clients' business trusts from associations to avoid the corporate tax, they were unsuccessful because the Supreme Court saw the "substance" through the "form".

Morrissey defined "association", a word which has not changed in the Code to

this date, by referring to its prior ruling in *Hecht v. Malley,* 265 U.S. 144, 351 (1924), the Court said,

> "Shorn of the restriction, the word `association' appeared to be used in its ordinary meaning, and we referred to several definitions found in standard dictionaries, as, e.g., `a body of persons united without a charter, but upon the methods and forms used by incorporated bodies for the prosecution of some common enterprise'; `a body of persons organized for the prosecution of some purpose, without a charter, but having the general form and mode of procedure of a corporation'; `an unorganized but unchartered body analogous to but distinguished from a corporation.' Id., p. 157. We expressed the view that the word `association,' as used in the excise tax provision of the Revenue Act of 1918, clearly included `Massachusetts trusts,' of the sort there involved, `having quasi-corporate organizations under which they are engaged in carrying on business enterprises."

In this line of early cases, it was convenient for the government to attack the "form" and to ask the Supreme Court to

look to the "substance" of these enterprises to declare that they were "associations" which could be taxed like corporations. In the case at bar, it is now convenient for the government to place "form" over "substance" and deny that the Massachusetts Business Trust is an "association" which could be taxed as a corporation. The Tax Court bought the Government's arguments, and the Second Circuit rubber-stamped the Tax Court's decision. Perhaps they assumed the Supreme Court was too busy to take the case on Petition or perhaps they themselves were too busy to take the time to understand this Supreme Court's 1935 decision which stands today as the last word on this subject. In either case, the Supreme Court's decision carried no weight with the lower courts.

What then did the Tax Court do that

directly conflicted with the *Morrissey* decision? It ruled that Carol was not an associate and, hence, the trust could not be an association. And, it did this using reasoning that was denounced by *Morrissey*.

Specifically, it looked at Carol's role in the enterprise in a demeaning manner and concluded that because she was a mere bookkeeper, she did not rise to the level of an associate or, to put it in the words of the Court, a person who "actively participated" in the enterprise. (The testimony actually showed that Carol was not only a bookkeeper, but a technical assistant, a typist, a plumbing code expert and she had other functions which were apparently overlooked by the Tax Court in its opinion.) It is clear that if Carol had a voice in the management of the enterprise, the Tax Court would have found that she was an associate. This can

easily be concluded from the following quotation taken from the Tax Court Opinion, Page 39, which is being repeated again here because it is so important:

> "Carol's role in WRC's operation was to keep the books for WRC.
>
> "At trial, Carol put it this way:
>
> `Q. (Izen) Who made the decisions? Who had the final say so with what was going to be done with the property of Water Resource Control and the assignment rights that it had in the toilet?
>
> `A. John Whitehouse.
>
> `Q. All right. Did you have any sort of input in the decisions that were made, business-wise?
>
> `A. No.
>
> `Q. Did Mr. Whitehouse consult you before they were made in any decisions?
>
> `A. Did he consult me about business decisions?
>
> `Q. Yes. The decisions --
>
> `A. No. He made his own business decisions. He's been

> doing that for a long time.
>
> "Accordingly, we conclude that Carol did not participate actively in WRC's creation or conduct.
>
> "Taking into account the elements described in *Elm Street Realty* and *Bedell*, it follows that Carol was not an \`associate' and so WRC does not meet the \`associates' test." (Tax Court Opinion, P. 39).

This quotation is the only trial transcript quotation in the Tax Court Opinion. The Judge obviously felt that it was important to emphasize that Carol had no <u>management voice</u>. It is equally obvious that if Carol had stated that she had made the business decisions, the Court would have found her to be an "associate". This is what this Petition is all about; the Supreme Court said, <u>management voice</u> was not to be an issue in finding "associates" for "associations". These petitioners had the right to expect that

the Supreme Court's ruling on this matter was the law of the land. The Tax Court ignored it, and the Second Circuit affirmed without opinion.

What did the Supreme Court say? The Supreme Court spoke of associations in the following specific terms:

> "'Association' implies associates. It implies the entering into a joint enterprise, and, as the applicable regulation imports, an enterprise for the transaction of business. This is not the characteristic of an ordinary trust -- whether created by will, deed, or declaration -- by which particular property is conveyed to a trustee or is to be held by the settlor, on specified trusts, for the benefit of named or described persons. Such beneficiaries do not ordinarily, and as mere *cestuis que trustent*, plan a common effort or enter into a combination for the conduct of a business enterprise. Undoubtedly the terms of an association may make the taking or acquiring of shares or interests sufficient to constitute participation, and may leave the management, or

> even control of the enterprise to designated persons. But the nature and purpose of the cooperative undertaking will differentiate it from an ordinary trust. In what are called 'business trusts' the object is not to hold and conserve particular property, with incidental powers, as in the traditional type of trusts, but to provide a medium for the conduct of a business and sharing its gains." (Pages 356-357). (Emphasis Supplied)

Again, at Page 360, this Court said:

> ". . . They were not the less associated in that undertaking because the arrangement vested the management and control in the trustees." (Emphasis Supplied)

That is exactly what Carol did. She left the management and control to her trustee husband and devoted her full time to support functions in the business. Apparently it was hard for this Tax Court judge to see that a woman carrying on support functions in a business is worthy of being called an " associate". Perhaps

this is why this judge fell back into the "management/control trap" even though he apparently knew that *Morrissey* ruled out management voice as being a factor in determining "associations".

No one knows exactly how much weight the Tax Court gave to Carol's lack of management voice in reaching its decision that she was not an associate, but from the way the Judge highlighted the above quotation, on lack of management voice, it looks like he gave it very significant weight when he shouldn't have given it any weight at all. Perhaps the rest of his consideration went to his belief that a woman supporting her husband in a business by doing traditional "woman's work" was simply not worthy of the recognition that goes along with a finding of "associate". In either case, something needs to be done to emphasize that the Tax Court must

follow the Supreme Court's decisions. Furthermore, we are past the time for demeaning the support functions of women in this country as they try to assist their husbands in small business ventures.

This case is simple, it will not consume significant time and effort compared to other more complex cases, but will provide an opportunity for this Court to signal the Tax Court that its rulings are to be followed. And at a time when the need for government revenue has never been greater, it will provide an opportunity to let the people know that this Court is ever vigilant to protect individual rights against any possible encroachment by a potentially overzealous tax collector.

It is respectfully requested that this Court grant this Petition.

Respectfully submitted,

John H. Whitehouse

John H. Whitehouse, Pro Se

Carol A. Whitehouse

Carol A. Whitehouse, Pro Se

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407-234-1030

APPENDIX

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 24th day of July one thousand nine hundred and ninety-two.

PRESENT: HONORABLE FRANK X. ALTIMARI,
HONORABLE J. DANIEL MAHONEY,
HONORABLE JOHN M. WALKER,JR.

JOHN M. WHITEHOUSE and CAROL A. WHITEHOUSE,

Petitioners-Appellants,

-against- No.92-4080

COMMISSIONER IF INTERNAL REVENUE,

Respondent-Appellee.

Appeal from the United States Tax Court.

APP-1

This Cause came on to be heard on the transcript of record from the United States Tax Court, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said court be and it hereby is AFFIRMED.

We affirm substantially for the reasons stated in T.C. Memo 1991-104, the memorandum opinion of the United States Tax Court, Herbert L. Chabot, Judge, in this case filed March 6, 1991. We note that we have carefully examined the trial record with regard to petitioners-appellants' contention that they were subjected to double taxation of 1979 engineering fees of $23,500 and 1980 consulting fees of $30,075, and find no error in the Tax Court's resolution of that issue.

Hon. Frank X. Altimari, U.S.C.J.

Hon. J. Daniel Mahoney, U.S.C.J.

Hon. John M. Walker, Jr.,U.S.C.J.

N.B. THIS SUMMARY ORDER WILL NOT BE PUBLISHED IN THE FEDERAL REPORTER AND SHOULD NOT BE CITED OR OTHERWISE RELIED UPON IN UNRELATED CASES BEFORE THIS OR ANY OTHER COURT.

T.C. Memo. 1991-104

UNITED STATES TAX COURT

WATER RESOURCE CONTROL, JOHN H.
WHITEHOUSE, Trustee, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

JOHN H. WHITEHOUSE AND CAROL A.
WHITEHOUSE, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket Nos. 18689-83, 18690-83
filed March 6, 1991.

Petitioner husband (H) invented a patentable water-economical toilet

(the "Meditator"). H. along with a promoter, (J), created a trust (T), exchanging rights in the Meditator for certificates of beneficial interest in T. H. ended as sole trustee, and petitioner wife (W) became the sole certificate holder. T's stated primary purpose was to manufacture the Meditator. A third part, the Meditator Company of California, run by J, bought the U.S. rights to the Meditator and marketed Meditator distributorships and paid a percentage of the proceeds to T. T used these funds for H and W;s personal expenses, and for making securities investments through another entity, whose bank account was controlled by H and W.

Held: (1) T is not an association taxable as a corporation, because it

dos not have associates. Sec 7701(a)(3), I.R.C. 1954; sec. 301.7701-2(a)(2), Proced. & Admin. Regs.

(2) T is subject to the grantor trust rules of sections 671 through 677, I.R.C. 1954. Thus, all its income and expenses are directly attributed to the grantor, H.

T transferred $265,000 to a bank account ostensibly owned by an entity of another individual, but in fact controlled by H and W. That bank account promptly transferred $260,000 back to T.

Held: (3) The transfers were merely circular movements of funds, and not a payment of a royalty followed by a loan; deduction disallowed. Other deductions

disallowed in whole or in large part because of T's failure to show the expenditures were made, or that the expenditures were business-related.

(4) T's proceeds from the sale of the U.S. rights to the Meditator are taxable as capital gains. Sec. 1235, I.R.C. 1954.

(5) H and W are subject to additions to tax for negligence under section 6653(a), I.R.C. 1954.

Joe Alfred Izen, Jr., for the
petitioners.

Robert J. Percy and Stephen C. Best,
for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

CHABOT, Judge: Respondent determined deficiencies in Federal trust income tax and additions to tax under section 6653(a)[1] (negligence, etc.) against petitioner Water Resource Control, in docket No. 18689-83, as follows:

		Additions to Tax
Year	Deficiency	Sec. 6653(a)
1979	$201,548.60	$10,077.43
1980	19,616.37	980.82

---

[1] Unless indicated otherwise, all section, subpart, part, subchapter, and chapter references are to sections, subparts, parts, subchapters, and chapters of the Internal Revenue Code of 1
1954 as in effect for the years in issue.

Respondent also determined deficiencies in Federal individual income tax and additions to tax under sections 6654(a) against petitioners John H. Whitehouse and Carol A. Whitehouse, in docket No. 18690-83, as follows:

Year	Deficiency	Additions to Tax Sec. 6653(a)
1979	$184,341.30[2]	$9,217.07
1980	13,006.16	650.31

These cases have been consolidated for trial, briefs, and opinion.

After concessions by the parties[3],

---

[2] $182,485.40 of this amount

[3] Respondent concedes that the two dockets involve duplication of income. Respondent also states that his main position is that the income and expenses of petitioner Water Resource Control (hereinafter sometimes referred to as "WRC") are taxable to petitioners John H. Whitehouse (hereinafter sometimes

the issues for decision are as follows:

(1) Whether the income and expenses of petitioner Water Resource Control are taxable to the individual petitioners.

(2) Whether petitioners have substantiated certain claimed deductions and credits.

(3) Whether petitioners are entitled to capital gain

---

[3] (...continued) referred to as "John") and Carol A. Whitehouse (hereinafter sometimes referred to as "Carol"). We interpret this to mean that, if we hold for respondent on his main position, against John and Carol in docket No. 18690-83, then respondent concedes the entire deficiency determined against WRC in docket No. 18689-83. Also, see n.17, infra. Petitioners do not dispute John's and Carol's liability for self-employment taxes if we rule for respondent on the issues for decision.

treatment on the sale of certain rights to an invention.

(4) Whether petitioners are subject to additions to tax for negligence under section 6653(a).

FINDINGS OF FACT

Some of the facts have been stipulated; the stipulation and the stipulated exhibits are incorporated herein by this reference.

When he petitions were filed in the instant cases, John and Carol, husband and wife, resided in West Suffield, Connecticut; WRC had its legal residence and principal office in West Suffield, Connecticut.

John has been self-employed in the business of inventing, designing, and manufacturing new products during his whole adult life. John ran a

business, called Whitehouse Engineering, as a sole proprietorship. John's and Carol's residence included a 9,000-square-foot barn, which was used for research and development. Carol assisted John in the development of some of his inventions, and kept the books for Whitehouse Engineering. John and Carol reported their income and deductions on the basis of cash receipts and disbursements.

John has no formal degree or license; however, he was educated in aeronautical engineering at Pratt Institute, and also attended Northeastern University and the Massachusetts Institute of Technology.

John designed and completed the prototype[e of a device called the Meditator toilet in or about 1971.

Before this time, John had invented other toilets and had improved on his inventions over the years. The Meditator tilt is a water-economical toilet. Other that prototypes and test models, no Meditator toilets were ever built.

John first met Paul S. Dane (hereinafter sometimes referred to as "Dane") in New York in 1939. (See our comments regarding Dane in n.19, infra.) Dane had an interest in the design of marine toilets. Dane was president of International Business Services, Ltd.[4] (hereinafter sometimes referred to as "IBS"), with a place of

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[4] The stipulations and exhibits refer to Dane's company at various times as "International Business Services, Ltd.", and "International Business Services Association Ltd."

business in Nassau, Bahamas.

Events of October 27-28, 1978

On the weekend beginning Friday, October 27, 1978, John met with James S. Jenkins (hereinafter sometimes referred to as ("Jenkins") from California. Jenkins was president of the Meditator Company. Jenkins proposed to sell Meditator toilet distributorships throughout the United States. Jenkins brought his lawyer, Richard Ellner (hereinafter sometimes referred to as "Ellner") to the meeting with John. Ellner advised as to the securities law consequences of selling the distributorships.

On Saturday, October 28, 1978, John and Jenkins created WRC. John consulted his own attorney, F. Michael Joseph, who, in his capacity as

notary, witnessed the signing of the WRC Contract and Declaration of Trust (hereinafter sometimes referred to as "the Trust Instrument") on October 28, 1978.

The duration of WRC was 10 years, unless sooner terminated or renewed at the sole discretion of the trustees. The Trust Instrument states that the purpose is to form WRC as a Pure Common Law Trust Organization. The preamble states as follows:

> PREAMBLE
>
> This Contract and Declaration of Trust (the "Indenture") is made this 28th day of October, 1978, by and between James S. Jenkins, of Woodland Hills, California, as Creator of this Common Law Trust Organization, and the below named Investor/Exchangor. The Creator has offered, and hereby offers to bargain, or exchange, in trade, the sum of One Dollar ($1.00) and all authorized Trust Certificate Units, for certain real and/or personal property of

John H. Whitehouse of West Suffield, Connecticut, as investor/exchangor, who, for the said sum and all One Hundred (100) Trust Certificate Units, the receipt and sufficiency of all of which is hereby acknowledged (which said investor considers to be full and adequate consideration for such exchange), accepts such offer and do (sic) hereby bargain, assign, convey, exchange, and deliver all that certain real and/or personal property of the investor/exchangor unto said Creator, who now temporarily takes and holds title thereto in the Trust Organization name, WATER RESOURCE CONTROL, pursuant to the terms hereof.

The purport of this instrument is that these same assets, and all interest therein, will be promptly assigned and conveyed to a Board of Trustees, so as to constitute the corpus of this Pure Common Law Trust Organization (frequently called "trust Organization"), hereby created and to begin forthwith, for the benefit of its certificate holders, with such assets to be held in fee simple by the trust, organization [sic] (or by its trustees, if otherwise required), in trust, for the period(s) hereof. Its purposes are to provide for the growth and preservation of the corpus, and

the safe, logical and economical administration thereof by natural and/or artificial persons or entities acting in a fiduciary capacity.

The Trust Instrument states as follows:

> CHARACTER OF THE TRUST ORGANIZATION
>
> It is hereby expressly declared that there is created a pure, common law form of trust, of the type commonly termed a business trust, and not a partnership, corporation or joint-stock association.[5]
>
> This trust is hereby created as a separate, legal entity. None of the Certificate Holders as such shall ever have or possess any legal or equitable title in any of the properties or

---

[5] In his testimony, John describes WRC as a "Massachusetts business trust". Neither side has dealt with the question of whether WRC would so qualify under Massachusetts law (or under the corresponding Connecticut law, the law of the State in which WRC was domiciled and in which was located WRC's principal place of business and principal office).

> assets of this Trust Organization. Full title (both legal and equitable) to all its assets and properties is merged in the Board of Trustees. Title to assets shall be held, and properties conveyed, as herein provided. Certificate Holders as such have absolutely no rights in the management of this Trust Organization, nor in the selection or replacement of its Trustees, nor control over them.

The Trust Instrument declares that Jenkins shall appoint the first trustee of WRC, after which the first trustee may independently appoint a second trustee, and they in turn may appoint a third trustee. The Trust Instrument provides that the trustees may, in the name of WRC, conduct andy and all business, deal with any property, and sue or be used, and that wrc"s principal place of business shall be in West Suffield, Connecticut, or elsewhere as

designated by the trustees.

The Trust Instrument provides as follows:

CHARACTER, ISSUANCE, TRANSFER AND OWNERSHIP OF CERTIFICATES

> This Trust Organization is authorized to issue One Hundred (100) Trust Units, each of equal value, to be evidenced by exchange to such persons, for such sums or other consideration, and on such terms, as they may deem expedient.
>
> Trustees shall issue or cause to be issued to such investors, certificates in such form as the trustees may deem proper, evidencing the beneficial interest of such share owners. The certificates shall be personal property and shall entitle the owners thereof to participate in all surplus and other distributions of net income as the Trustees from time to time may declare and pay out. This is an option, and not a duty. The Holders of record of trust Certificates shall be entitled only to their proportionate shares of any such distributions, and of the assets upon dissolution as provided herein.

The only relationships of the Certificate holders to the Trustees and to this Trust Organization, are those described herein and none other. There are to be no meetings of the Certificate Holders as such. Except as provided in this declaration of trust, no holder of a certificate evidencing ownership of an interest in the trust shall have any authority, power or right whatsoever to transact any business for or on behalf of the trust, or the Trustees hereof, in connection with the trust property, or any part thereof, and shall have no interest in the specific property belonging to the trust, or in any part thereof, except the rights to receive the income and distributable funds arising therefrom as set forth herein.

The rights of Certificate Holders and of transferees and other persons becoming entitled to shares of the trust shall be subject to all the terms and conditions of this declaration of trust. No Certificate Holder shall have any right to a partition of the trust property or to an accounting during the continuance of the trust.

With the prior approval of the Board of Trustees, Trust Units (and the Certificates

representing the same) shall be transferable before the death or dissolution of the registered Holder thereof, by a simple assignment in writing, accompanied by surrender of such Certificate(s) to the Trustees or their agent, but no transfer shall be effective against the Trustees (even with actual or constructive notice), unless and until approved by them and a record of the new Certificate has been duly noted in the Minutes of the Trust Organization. On the transfer, surrender, or release thereof from the registered Holder, a new Certificate shall be issued to the designated transferee(s). In case of a transfer of only part of the total Units held, a new Certificate for the residue shall be issued to the transferor.

In case of loss or destruction of a Certificate of shares, a new one may be issued in its place, on such conditions as the Trustees may deem necessary and proper."

The Trust instrument provides as follows:

POWERS AND DUTIES OF TRUSTEES AND OFFICERS

The original Trustee and the

Board thereof, for themselves and their successors, hereby accept the assignment and conveyance, in trust, upon the terms and conditions of this Indenture, and receipt for the delivery of all the assets and properties listed in Schedules A and B hereto[6], together with related supporting documents. They agree to conserve, build and improve upon the assets of the Trust Organization in such manner as may increase its value and financial rating, exercising their best judgment and discretion, and in all other respects to administer their duties in good faith and in conformity with the provisions hereof. All funds received or paid into the treasury are, and shall become, part of the corpus of the Trust Organization.

Trustees shall hold the legal title to all property at any time belonging to the Trust, and shall have absolute and exclusive control, management and disposition hereof, and absolute and exclusive power and control

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[6] The only property listed on Schedule A to the Trust Instrument is the Meditator toilet. There is not any Schedule B to the Trust Instrument.

over the management and conduct of the businesses and affairs of the trust, free from any power of control on the part of the Certificate Holders.

Trustees may hold, manage, deal with and dispose [sic] of the property and business of the trust in the same manner as if they were the absolute proprietors thereof, subject only to the specific limitations herein placed on their powers. The enumeration of powers contained herein shall not be construed as limiting in any way the general powers hereby conferred on Trustees. They shall have all powers necessary, convenient, or appropriate to the purposes and ends of this trust, and are authorized to take any action which they may deem proper to carry out such purposes.

Trustees shall have the powers, among others, to purchase or otherwise acquire property, patents, inventions, and to sell, exchange, lease, mortgage, pledge, or in any manner dispose, encumber, improve, or deal with the property of the trust, or any part thereof or any interest therein, on such terms and for such consideration and purposes as they deem proper. Trustees may engage in business, manufacture and deal in good,

> wages and merchandise, incur indebtedness, borrow or loan money with or without security, enter into contracts of all kinds, execute, accept, discount, negotiate and deal in commercial paper and evidences of indebtedness, execute conveyances, mortgages, deeds of trust, leases and any other instrument in writing; they may invest and reinvest the trust funds; they may compromise or settle any suits, claims, or demands, or waive or release any rights, relating to the trust property or business;they may appoint and employ officers, agents, attorneys and servants. Trustees may sue and be sued and prosecute and defend any and all actions affecting the trust or its business or property, either in the name of the trust or in their own names; they may adopt and enforce such rules and regulations not inconsistent with the provisions of this instrument, as they may from time to time deem expedient.

Under the Trust Instrument, the Trustees may set there own compensation , amend the Trust Instrument, and lengthen or shorten the term of the trust, without

obtaining anyone else's concurrence, as follows:

COMPENSATION OF TRUSTEES

Trustees shall receive such compensation, regular or special, as they shall deem reasonable and proper. They shall fix the compensation, if any, of all officers and agents appointed by them.

* * * * * * * * * *

AMENDMENTS

This declaration of trust may be amended in any particular, except as regards the liability of the Certificate Holders, by the Trustees, by an instrument in writing, signed by the Trustees and setting out the amendment.

DURATION, TERMINATION AND CONTINUATION

This Trust Organization shall continue for a period of ten (10) years from date, unless sooner terminated. The Trustees may, in their unanimous discretion, because of a change in conditions, threatened depreciation in values, or for any other reason only to them deemed good and sufficient, liquidate and\or distribute the remaining assets as provided

> below, and close the Trust Organization at an earlier date fixed by them. A Resolution of early termination shall be placed in the Minutes.
>
> At any time before the above provided expiration date, the then Trustees, if they so desire and believe that said Trust Organization should be continued, may renew, and likewise before the expiration of any renewal period, may further renew, this Contract and Declaration of Trust for a like or shorter time period. A Resolution of such renewal or further renewal shall be entered into the Minutes.

The first meeting of WRC was held on the day it was created. WRC gave $1 and the 100 certificates of beneficial interest to John and Carol; John gave the Meditator toilet to WRC in return. John and Carol each received 50 certificates of beneficial interest. John immediately assigned his certificates to Carol in exchange for $1. Carol remained the only

holder of the certificates of beneficial interest throughout the years in issue. Jenkins also appointed John as the first trustee of WRC and John accepted that appointment.

Also on October 27, 1978, a contract entitled Agreement to Manufacture (hereinafter sometimes referred to as "the Manufacturing Agreement") was signed by John as trustee of WRC and by Jenkins as president of the Meditator Company. The Manufacturing Agreement provided that WRC would manufacture the Meditator toilet.

Another contract entitled Invention and Patent Purchase Agreement (hereinafter sometimes referred to as "the Distribution Agreement") was

signed on October 28, 1978. The Distribution Agreement was signed by John as trustee of WRC and by Jenkins as president of the Meditator Company, and assigned all United States rights in the Meditator toilet to the Meditator Company. The Meditator Company, which had already paid $10,000 to WRC, agreed to pay an additional $90,000 to WRC on the signing of the Distribution Agreement. The Distribution Agreement called for WRC to receive 20 percent of the proceeds from the Meditator Company's distributorship sales. WRC reported on its 1979 tax return that it received $293,805 from the Meditator Company as a result of this agreement

Subsequent Transactions

On February 1, 1979, John filed a

patent application for the Meditator toilet with the United States Department of Commerce, Patent and Trademark Office. The Patent and Trademark Office determined (in August 1980) that a patent was allowable, but considered the patent application abandoned when John failed to pay the necessary fee on time. As a result, no patent was issued on the Meditator toilet.

John made all of the business decisions for WRC. Carol kept the books for WRC, as well as for Whitehouse Engineering. WRC's income and expenses were reported on the basis of cash receipts and disbursements. Petitioners filed tax returns for WRC for 1979 and 1980, using Form 1041 (U. S. Fiduciary

Income Tax Return) for both years.

John opened a bank account (hereinafter sometimes referred to as "the WRC Bank Account") under WRC's name on or about October 31, 1978. Tables 1 and 2 show deposits and withdrawals respectively, from the WRC Bank Account for the period March 14, 1979, through April 30, 1086.

Table 1

Deposits Into WRC Bank Account

Date	Amount	Payor
10/12/79	$164,054.62	A.G. Edwards & Sons,
10/19/79	33,625.00	"
10/19/79	28,437.63	"
11/02/79	100,000.00	IBS (signed by Dane)-
11/06/79	160,000.00	IBS (signed by Dane)
11/19/79	196,887.02	(damaged film)*
03/03/80	2,000.00	A.G. Edwards & Sons, Inc.

04/03/80	3,000.00	(damaged film)
04/08/80	3,000.00	(credit memo)
05/09/80	2,000.00	A.G. Edwards & Sons, Inc.
05/19/80	1,000.00	" "
06/04/80	2,000.00	A.G. Edwards & Sons, Inc.
06/05/80	25.00	Third National Bank
06/05/80	140.00	Taylor Rental Corp.(dividend)
06/05/80	1,000.00	A.G. Edwards & Sons, Inc.
06/26/80	1,000.00	" "
08/13/80	3,000.00	" "
11/04/80	100.00	NA**
11/04/80	140.00	Taylor Rental Corp.(dividend)
12/31/80	140.00	" "
01/06/81	5,000.00	A.G. Edwards & Sons, Inc.
01/19/81	20,000.00	IBS (signed by Dane)
04/21/81	100.00	NA
07/07/81	10,000.00	A.G. Edwards & Sons, Inc.
01/14/81	25.00	NA
05/27/82	1,000.00	IBS (signed by Dane)
11/18/82	5,918.24	A.G. Edwards & Sons, Inc.

11/18/82	15,254.76	A.G. Edwards & Sons, Inc.

* A "damaged film" reference means that the bank stated that it was unable to reproduce a photocopy of the item due to damaged film.

** The "NA" reference means that the information is not available from the records.

Table 2
Checks Drawn on WRC Bank Account

Date Paid	Amount	Payee
03/14/79	$ 4,000.00	NA (SEE ** IN Table 1)
10/29/79	1,000.00	cash (endorsed by Carol)
10/29/79	213,000.00	IBS
10/29/79	10,000.00	Elaine J. Wold(cert.Ck)
11/05/79	33,875.00	A. G. Edwards & Sons, Inc.
11/08/79	65,000.00	" "
11/08/79	2,000.00	Whitehouse Engineering
11/20/79	160,000.00	A.G. Edwards & Sons, Inc.
11/21/79	100.00	S. E. Hahn
11/21/79	1,000.00	Cash (end. by J & C.)
11/23/79	193,000.00	IBS
11/28/79	4,000.00	Whitehouse Eng.
03/07/78	2,000.00	"

04/15/78	3,000.00	(damaged film)
05/14/78	2,494.00	IRS
05/15/78	2,000.00	Whitehouse Eng.
06/06/79	1,500.00	"
06/10/79	2,000.00	"
06/26/79	250.00	Cash (by John)
07/02/79	2,000.00	(damaged film)
08/27/79	3,000.00	Whitehouse Eng.
11/13/80	110.00	NA
11/26/80	24.75	"
01/02/80	24.75	The Hartford Club
01/21/81	24,650.00	(Damaged film)
01/22/81	182.90	Hartford Club
02/24/81	119.22	NA
04/01/81	25.00	"
04/02/81	42.33	"
04/23/81	228.00	"
04/29/81	58.72	"
05/28/81	24.75	"
07/09/81	9,800.00	Fechtor, Detwiler
07/13/81	41.44	NA
08/05/81	24.75	"
09/02/81	27.50	"
10/23/81	90.00	"
01/22/82	27.50	"
06/082	1,000.00	Whitehouse Eng.
11/29/82	6,000.00	A.G. Edwards & Sons
12/16/82	1,952.50	Menard Oil
12/23/82	4,000.00	Cash
01/20/83	8,900.00	Fechtor,

Service charges and similar charges were imposed on the WRC Bank Account during the years and in the amounts shown in table 3.

Table 3

Year	Amount
1979	$ 3.48
1980	7.53
1981	18.42
1982	35.77
1983	14.84

Royalty Expense

Carol opened a bank account in the name of IBS (hereinafter sometimes referred to as "the IBS Bank Account") with a $200 initial deposit. The IBS Bank Account was in the same branch of the bank in which the WRC Bank Account was held. Carol and Dane were the signatories on the IBS Bank Account.

The address on the IBS Bank Account was that of John and Carol. Tables 4 and 5 show deposits into and checks drawn on the IBS bank account for the period October 29, 1979, through November 7, 1983.

Table 4

Deposits Into IBS Bank Account

Date	Amount	Payor
10/29/79	$ 52,000.00	WRC
10/29/79	213,000.00	WRC
11/23/79	193,000.00	WRC
04/01/80	6,462.50	daily cash *
10/08/80	43,000.00	(damaged film)
10/08/80	57,000.00	"
12/31/80	6,462.50	daily cash
12/31/80	6,462.50	"
01/14/82	475.31	NA

* The "daily cash accumulation fund" appears to refer to a brokerage account with A.G. Edwards and Sons, Inc., on which WRC could draw funds.

Table 5

Checks Drawn on IBS Bank Account

Date Paid	Amount	Payee
11/02/79	$ 100,000.00	WRC
11/06/79	160,000.00	WRC
12/10/79	25,000.00	Midas Mgmt

12/14/79	172,000.00	WRC
11/07/80	47,000.00	Midas Mgmt
11/07/80	53,00.00	"
01/19/81	20,000.00	WRC
05/27/82	1,000.00	NA

After the $1,000 check was paid out of the IBS Bank Account, on May 27, 1982, the balance in the account was $54.26. The only transactions in the IBS Bank Account thereafter were $4 monthly activity charges, until the balance was completely eliminated.

On the same day that Carol opened the IBS Bank Account with a $200 deposit, WRC made two checks payable to IBS, one for $213,000, and the other for $52,000.[7] for a total of $265,000. A deduction of $265,000 for "royalties" paid to IBS was claimed on

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[7] The $52,000 check was drawn on WRC's account with another bank, the Northern Connecticut National Bank.

WRC's 1979 tax return.

* * * * * *

John and Carol controlled the IBS Bank Account. The $265,000 payment from WRC to IBS did not represent a royalty payment from petitioners to Dane for work on the Meditator toilet.

Brokerage Activity

In early November 1979, checks for $100,000 and $160,000 were written on the IBS Bank Account and deposited into the WRC Bank Account. John and Carol planned to trade these funds in WRC;s name in the stock market. Since January of 1979, WRC had maintained a brokerage account (hereinafter sometimes referred to as "the Brokerage Account") at A. G. Edwards & Sons, Inc. (hereinafter sometimes referred to as "A. G. Edwards").

In early November 1979, a total of $258,875 was drawn on the WRC Bank Account and deposited into the Brokerage Account. During 1979 and 1980, funds were transferred back and forth between the WRC Bank Account, the IBS Bank Account, the Brokerage Account, and other accounts held in the name of WRC.

WRC received $578 and $906 in dividend income from the Brokerage Account in 1979 and in 1980, respectively; this income was reported on WRC's 1979 and 1980 tax returns. WRC received $9,422 and $9,466 in interest income from the Brokerage Account in 1979 and 1980; this income was reported on WRC's 1979 and 1980 tax returns. WRC received $10,219 and $36,171 in net short-term capital gain

from the Brokerage Account in 1979 and 1980, respectively, this income and the underlying capital gain and loss transactions were reported on WRC's 1979 and 1980 tax returns. The $10,219 reported on WRC's 1079 tax return resulted from 34 sales, with an aggregate gross sales price of $268,521 and an aggregate cost or other basis of $258,302; each of the 34 sales produced a short-term gain or loss. The $36,171 reported on WRC's 1980 tax return resulted from 310 sales, with an aggregate gross sales price of $2,951,233.24 and an aggregate cost or other basis of $2,916,502.42[8]; each of the 310 sales

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[8] One of the transactions, shown as "Put Nom June 35" appears to have produced a loss of $720.03 (gross sales price of $308.75, cost or other

produced a short-term gain or loss.

A/ G/ Edwards did not charge interest to WRC on account of the Brokerage Account in 1979.

A. G. Edwards charged interest in the amount of $241.66 to WRC on account of the Brokerage Account in 1980.

WRC deducted interest in the amounts of $6,463 and $13,205 on its 1979 and 1980 tax returns, respectively. In the notice of deficiency, respondent disallowed both amount in full.

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basis of $1,028.78). However the $720.03 is shown in the "GAIN" column. It thus appears that WRC overstated its capital gains by $1,440.06. This, plus rounding, accounts for the difference between (1) WRC's reported capital gains and (2) the excess of the aggregate of WRC's reported gross sales price over the aggregate of WRC's reported cost or other basis.

Whitehouse Engineering Fees

On January 2, 1979, WRC (by John, as trustee) and Whitehouse Engineering (by John, as president) signed an "Engineering, Design and Consulting Contract". A deduction of $23,500 for "engineering fees" was claimed on WRC's 1979 tax return in connection with WRC's expenses under this contract.

On January 2, 1980, WRC and Whitehouse Engineering (by John as trustee and as president, respectively) signed a second "Engineering, Design and Consulting Contract". A deduction of $30,075 for "consulting fees" was claimed on WRC's 1980 tax return in connection with WRC's expenses under this contract.

Arthur H. Edwards & Co.

Petitioners received an invoice from an accounting firm, Arthur H. Edwards & Co. (hereinafter sometimes referred to as "Arthur H. Edwards"), addressed to John Whitehouse Engineering and dated December 21, 1979. The invoice states that the fee is for "Services rendered in preparation of making projections, cost analysis in connection with 'The Meditator'." Beneath the balance due amount are the words "Water Resource Control Expense" in parentheses. By a check dated October 30, 1979, and drawn on a "Daily Cash Accumulation Fund", petitioners paid $5,000 to Arthur H. Edwards on account of the invoice. On WRC's 1979 tax return, this $5,000 expense was deducted as having been paid for "legal and

professional expenses."[9]

The Limousine

On or about October 29, 1979, John bought a used 1976 Cadillac Fleetwood Limousine (hereinafter sometimes referred to as "the Limousine"), with a $10,000 check drawn on the WRC Bank Account. (See table 2, supra, check to Elaine J. Wold.) The Limousine was registered in Connecticut in John's name, and was till in John's possession at the time of the trial.

An investment credit of $333 and a deduction of $1,000 for depreciation on the Limousine were claimed on WRC's

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[9] We are puzzled by the use of a check dated October 30, 1079, to pay an invoice dated December 21, 1979. However, the parties; stipulations so state, and accordingly we so find.

1979 tax return. Deductions of $626 for "auto expense", $294 for "insurance", and $125 for "rent" on account of the Limousine were claimed on WRC's 1980 tax return.

Midas

John and Carol west to Florida in October or November 1979 and stayed until the spring of 1980. John and Carol opened a bank account in Florida in the name of Midas Management Association, Ltd. (hereinafter sometimes referred to as "Midas"). Petitioners transferred funds from the WRC Bank Account to the IBS Bank Account, and then moved money from the IBS Bank Account to the Midas bank account in Florida. A total of about $125,000 in transfers to Midas in Florida between 1979 and 1980 was

ultimately deposited into the Brokerage Account.

WRC's Tax Returns

On its 1979 fiduciary tax return (Form 1041), WRC reported $293,805 of business income and $301,258 of business expenses, for a loss of $7,433. WRC reported $20,228 of other income, $400 of miscellaneous deductions (for taxable income of $12,395), and a tax liability of $2,494 (after investment credit of $333.)

On its 1980 fiduciary tax return (Form 1041), WRC did not report any business income or expenses. WRC reported $46,543 of total income, $44,585 of interest and other expenses, $400 of miscellaneous deductions (for taxable income of

$1,558), and a tax liability of $228. WRC's reported income consists of dividends ($906), interest ($9,466), and capital gain ($36,171).

* * * * * * *

The parts of the deficiencies die to the claimed royalty deduction (1979), the claimed Limousine deductions (1979 and 1980), the claimed Limousine investment credit (1979), and the claimed engineering and consulting fees deductions (1979 and 1980) are due to negligence or intentional disregard of rules and regulations.

OPINION

I. Expenses and Credits

In a sense, the tax status of WRC might be viewed as a threshold issue, to be dealt with before proceeding to

the specific adjustment items. However, the analyses of a number of the specific adjustment items constitute predicates for parts of the analysis of the WRC status issue. We have concluded that the instant opinion would be clearer if we proceeded first to deal with the specific adjustment items.

A. Royalty Expense

Petitioners assert that the claimed 1979 $265,000 royalty payment to IBS has been substantiated, and that the payment is properly deductible currently, under section 174. Respondent contends that petitioners have not substantiated a payment of $265,000 in royalties to IBS, since the ostensible payment by WRC to IBS was followed promptly by

IBS' transferring funds to WRC. Respondent argues that if the payment occurred, then it is not deductible, but rather must be capitalized under section 174. Petitioners respond that the transfer from IBS to WRC was a loan.

We agree with respondent that there was no payment of royalties.

Section 162(a)[11] allows a

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[11] Section 162(a) provides, in pertinent part, as follows:

> SEC. 162. TRADE OR BUSINESS EXPENSES.
> (a) In General.--There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * *

taxpayer to deduct the ordinary and necessary expenses of carrying on that taxpayer's trade or business.

We have found that the IBS Bank Account was controlled and directed by John and Carol. On October 27, 1979, WRC made two checks payable to IBS, for a total of $265,000. (See n.7, supra.) The checks were deposited into the IBS Bank Account on October 29, 1979. (Table 4, supra.) On November 1 and November 6, 1979, IBS made two checks payable to WRC, for a total of $260,000. (Table 5, supra.) The checks were deposited into the WRC Bank Account on November 2 and November 6, 1979.[11] (Table 1, supra.)

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[11] Each of the checks from WRC to IBS is endorsed as follows: "Deposit in full International Business Assoc LTD". To the Court, the handwriting

Thus the money paid by WRC to IBS was returned by IBS to WRC within a week.

Both John and Carol testified that IBS loaned the money back to WRC.[12] Petitioners did not produce any documentary evidence of the loan.

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is similar to Carol's. However, Carol categorically denies having written the endorsements, and so we have not made any finding of fact on that point.

[12] Carol's testimony and petitioners' brief insist that the loan was in the amount of $265,000, even though the checks from IBS ($100,000 and $160,000) clearly added up to only $260,000. Petitioners have not offered any explanation for the $5,000 shortfall. Also, Carol testified that the $25,000 check from IBS to Midas (table 5, supra) was part of the IBS loan to WRC. This would make the total loan $285,000 ($100,000 and $160,000 and $25,000). Petitioners have not offered any explanation for what appears to be a $20,000 overage, under their theory of the case.

Petitioners did not produce Dane or anyone else who could testify on behalf of IBS> Petitioners did not explain why, if one loan of $265,000 was intended, then IBS made the loan in two checks rather than one and why the checks were dated 5 days apart from each other (i.e., Nov. 1 and Nov. 6). Also, as tables 4 and 5, *supra*, show, almost all the money deposited in the IBS Bank Account made its way back to the WRC Bank Account or to the Midas bank account, another account established by John and Carol.

We conclude, and we have found, that the $265,000 transfer from the WRC Bank Account to the IBS Bank Account was not a payment of royalties. Indeed, we believe it is more likely than not that it was part

of a "shell game" in which funds were moved from one pocket to another--all pockets being under the control of John and Carol--in an attempt to create an illusion of business transactions, or other real-world transactions. We believe there was no substance to these transfers.

We hold for respondent on this issue.

B. Whitehouse Engineering Fees

We hold, infra, that WRC is a grantor trust and its income and expenses are taxable to John.

Respondent concedes that, to the extent any amounts received from WRC were reported on John's and Carol's tax returns as Whitehouse Engineering's receipts, the disallowance of these deductions

($23,500 for 1979; $30,075 for 1980) to WRC (and thus, to petitioners) would result in a duplication of income. If the deducted amounts were not reported as Whitehouse Engineering receipts , then allowance of a deduction to WRC would (through the grantor trust provisions) result in overstating John's deductions (or understating his business income).

Petitioners have not produced any persuasive evidence to show that the amounts had in fact been reported by Whitehouse Engineering. We concluded that because petitioners have failed to establish that Whitehouse Engineering reported the payments as income, the payments are not deductible as engineering and consulting fees.

We hold for respondent on this issue.[13]

C. Bank Charges

WRC deducted $25 as "Bank Charges" on its 1979 tax return. Respondent contends that petitioners are not entitled to any of this amount, because it has not been substantiated. Petitioners argue that they have documented the bank charges

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[13] Both respondent and petitioners discuss (a) whether the payments have been substantiated, and if so, then (b) whether they are properly deductible. We do not reach these questions, since we conclude that petitioners have not established that Whitehouse Engineering reported these amounts as income. However, we note that petitioners have failed to produce any evidence regarding these expenses, other than invoices from Whitehouse Engineering, to WRC. Also, it is difficult to relate the 1980 expense of $30,075 to any business activity of WRC. All of WRC's 1980 income was passive or derived from hundreds of securities transactions.

through production of petitioners' bank records.

We agree largely with respondent.

Neither side has favored us with a reference to any evidence in the record bearing on this matter. However on the basis of the stipulated statements of the WRC Bank Account, we have made the findings set forth in table 3, _supra_.

We hold on this issue that WRC paid $.3.48 in bank charges in 1979.

D. The Limousine

Respondent contends that petitioners are not entitled to their 1979 claimed depreciation deduction and investment credit and their 1980 claimed auto expense, insurance, and rent deductions on account of the Limousine because (1) petitioners have

not shown that the Limousine was used in their trade or business and (2) as to the 1980 deductions petitioners have not shown that money was spent for the claimed purposes. Petitioners argue that the Limousine was so used and the money was so spent.

We agree with respondent's first contention.

The business use of the Limousine, according to John, was to ferry potential investors from an airport in Florida, to a site the WRC had leased from the city of Sebastian, Florida, for a pilot plant to manufacture the Meditator toilet. The toilets were not manufactured. The plant was not built. We are told that the lease expired. We have no documentary evidence of the lease. We

have no evidence as to the Limousine's mileage in this shuttle operation. We have no evidence as to who came to view the plant site and when. WE know that the Limousine was registered in Connecticut, despite its asserted Florida usage. We know that the Limousine was registered in John's name despite its asserted purchase for WRC's business purposes. Also, as to 1980 we are not persuaded that there was any WRC trade or business to which the Limousine could reasonably have been related. All of WRC;s 1980 income was passive or derived from hundreds of securities transactions.

All in all, based on the meager information in the record on this point, we conclude that petitioners have failed to persuade us that there

was any trade or business use of the Limousine in either of the years before the Court. The claimed credit and claimed deductions are not allowable in the absence of trade or business use. Accordingly, petitioners are not entitled to the claimed credit or any of the claimed deductions.

We hold for respondent on this issue.

E. Interest

The status of the parties' dispute is unclear. WRC claimed interest deductions of $6,463 for 1979 and $13,205 for 1980. Respondent disallowed both items in full. At trial, it appeared that the foundation for the claimed deductions was three checks, each in the amount of

$6,462.50, from WRC' daily accumulation account with A. G. Edwards and deposited into the IBS Bank Account (see table 4, supra). Carol testified that she thought these checks represented WRC's payments of interest to IBS on IBS's asserted $265,000 loan to WRC. The next day, petitioner's counsel stated as follows after Carol completed her testimony:

> MR. IZEN: What I want to make clear is that it appears that there was an effort to pay IBS back, and the Petitioners are conceding that they never paid IBS back. Yesterday, Mrs. Whitehouse's testimony mentioned something I think, about interest on the loan for -- that IBS made to Water Resources. Well, the principal was never paid back of the loan. Even if you could those three $6,400 and-some-od-dollar checks that are from that daily cash accumulation fund, you don't come up with any extra monies that Water Resource Control made for an interest deduction. So we concede that.

> That those $6,000 accumulation fund checks are in no way deductible to pay --those funds represent part of the original loan proceeds.

Respondent agreed at that time that any interest expense shown on the Brokerage Account records is deductible. On brief, respondent concedes that interest of $241.66 was paid.

On opening brief, petitioners' only reference to the interest issue is the following request for finding of fact:

> 92. Petitioners incurred an additional $280.00 in deductible interest over and above that allowed by Respondent's Notices of Deficiency. (TR p. 293, LL 1-19).

On answering brief, petitioners reject the idea that they have conceded the interest deductions that WRC claimed on its tax returns.

We agree with respondent.

Firstly, petitioners' counsel's statements at trial and on opening brief constitute a concession of the interest deductions claimed on WRC's tax returns.

Secondly, there was no debt from WRC to IBS and so no foundation for liability for interest. (See our discussion under A. Royalty Expense, Supra.) That is, the transfers from WRC to IBS and back were merely circular and not a payment of royalties followed by a loan.

Thirdly, tables 4 and 5 and the text immediately following show that all the proceeds of the three checks from WRC to IBS, that assertively constitute the payments of interest, found their way back to WRC or to John and Carol's other creation, Midas.

Fourthly, we have examined the stipulated Brokerage Account records in detail. Out conclusion as to interest expense matches respondent's concession of $241.66, and we have so found. Petitioners have not favored us with any explanation of the $280 amount they refer to.

We hold for respondent on this issue.

F. Fee -- Arthus H. Edwards

Respondent contends that petitioners may not deduct the $5,000 fee paid in 1979 to Arthur H. Edwards for services rendered in making projections and cost analyses in connection with the Meditator toilet, because it is an organizational

expense that must be capitalized (sec. 263).

Petitioners contend that the payment is deductible for 1979 as an ordinary and necessary trade or business expense (sec. 162) or an expense of earning income (sec. 212).

We agree with respondent.

We take as its face value some of John's and Carol's testimony about WRC's preparing to go into business to exploit the Meditator toilet in some manner. Although WRC had received almost $300,000 from the sale of distributorships, nothing was yet done to enable WRC to have the Meditator toilet manufactured. Under these circumstances, the work done by Arthur H. Edwards, to the extent it is characterized by evidence in the

record, appears to be "start-up" or "preopening" activity, the cost of which ordinarily is to be capitalized, under the "preopening" activity, the cost of which ordinarily is to be capitalized, under the "preopening expense doctrine". The expense is not currently deductible under section 162 or section 212. Hardy v. Commissioner, 93 T.C. 684 (1989), on appeal (AC10, April 20, 1990).

We hold for respondent on this issue.[14]

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[14] Petitioners' contentions relate to 1979 deductibility. However, it might be argued that, by the end of the period before us (i.e., 1980) the work done by Arthur H. Edwards had been abandoned. (John abandoned his efforts to secure a patent; WRC did not show any business income or business expenses on its 1980 tax return; WRC's 1980 activities were limited to hundreds of purchases and sales of securities.) Under our

G. Miscellaneous Items

Respondent contends that petitioners are not entitled to deductions of $250 for office supply expenses in 1979 or $160 for dues paid to the Hartford Club in 1980. Petitioners have failed to provide any evidence or testimony that would substantiate thee deductions and credits. Thus, petitioners have not met their burden of proof with respect to these items.

We hold for respondent on these issues.

H. Sale of Meditator Rights

Petitioners argue that John and

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precedents, even if the abandonment argument had been mae, the expense would not be deductible under section 165. O'Donnell v. Commissioner, 62 T.C 781,786 (1974), affd. without published opinion 519 F.2n 1406 (CA7 1975).

Carol are entitled to capital gains treatment on the payment from the Meditator Company to WRC for the rights to the Meditator toilet. Respondent contends that because petitioners treated this income as ordinary income on the tax returns that they filed on behalf of WRC, petitioners are bound by such treatment.

We agree with petitioners.

Section 1235(a) provides that a transfer of "all substantial rights" to a patent be any holder shall be considered the sale or exchange of a capital asset.[13] In the instant

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[13] SEC. 1235. SALE OR EXCHANGE OF PATENTS.
(a) General.--A transfer (other than by gift, inheritance, or devise) of property consisting of all substantial right to a patent, or an

cases, the Meditaotr toilet was never actually patented. However, it is not necessary that the patent or patent application for the invention be in existence if the requirements of section 1235 are otherwise net.[16] We

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undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more that 1 year, regardless of whether or not payments in consideration of such transfer are--

(1) payable periodically over a period generally coterminous with the transferee's use of the patent, or

(2) contingent on the productivity, use, or disposition of the property transferred.

[The subsequent amendment of this provision by sec. 1001 (b)(19) of the Deficit Reduction Act of 1984 (Pub. L. 98-369, 98 Stat. 494, 1012) does not affect the instant cases.]

[16] Sec 1.1235-2. Definition of terms.--For the purposes of section 1235 and 1.1235.1--

(a) Patent. The term "patent"

conclude that the requirements of section 1235 are indeed otherwise met. The Distribution Agreement states as follows:

> WRC hereby assigns to TMC [the Meditator Company] all right, title and interest in and to the invention of the Meditator toilet for the United States only, including the right to sublicense others, to make, use and sell Meditator toilets incorporating or made in accordance with or by use of the design, engineering and manufacturing data and know-how of WRC or John H. Whitehouse or which is or may become covered by one or more U. S. Patent Rights of WRC. * * *

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means a patent granted under the provisions of title 35 of the United States Code, or any foreign patent granting rights generally similar to those under a United States patent. It is not necessary that the patent or patent application for the invention be in existence if the requirements of section 1235 are otherwise met.

The only rights in the Meditator toilet that WRC retained were (1) the non-U.S. rights; (2) the right to bring an action against third-party infringes, but only with the permission or failure to act of the Meditator Company; and (3) the right to terminate the agreement if the Meditator Company were to become insolvent or default on its payments to WRC. It is clear that retaining such rights does not result in a determination that less than all substantial rights were transferred to the purchaser. Taylor-Winfield Corp. v.Commissioner , 57 T.C. 205 (1971), affd. 467 F.2d 483 (CA6 1972); Young v. Commissioner, 29 T.C. 850 (1958),

affd. 269 F. 2d 89 (CA2 1959). We conclude that, under the Distribution Agreement, WRC transferred all substantial rights in the Meditator toilet to the Meditator Company. Thus, the transfer of the rights was a sale under section 1235, and petitioners are entitled to treat the $293,805 as a capital gain.

We hold for petitioners on this issue.

II. TAX TREATMENT OF WRC

Respondent would tax WRC's income to John[17] either because WRC was part of Whitehouse Engineering (John's sole

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[17] Respondent concedes that there is a duplication of the income items in the two dockets before us. Respondent conceded that, if we hold that John is taxable on WRC's income, then John should also be entitled to the deductions attributable to those items. See n.3, supra.

proprietorship), or because WRC was a grantor trust (with John as the "grantor"). Petitioners maintain that WRC is a separate entity, taxable as a corporation on its own income.[18]

We first consider whether WRC is an "(association" taxable as a corporation, then whether WRC is a grantor trust.[19]

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[18] At trial, petitioners' first alternative was that WRC should be taxed as shown on its tax returns; i.e., a trust which is not a grantor trust. Association status was a second alternative. On brief, petitioners have reversed the order of their preferences.

[19] At trial, a question arose as to whether John remains the fiduciary of WRC, in light of his testimony that he had turned WRC over to Dane in 1983. Dane was described as a British national who worked as an undercover agent monitoring German espionage activities in the United States before World War II, and who had lived in various places in the Caribbean and

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South America. What purports to be Dane's signature appears on various checks and other documents. He fits, more or less, into petitioners' story at convenient spots. The asserted transfer of WRC to Dane in 1983 is John's and Carol's explanation for their inability to produce numerous requested documents. (We note that, in 1982, respondent's auditor asked John to produce WRC's records for 1979 and 1980. Thus, John's testimony is that he got rid of WRC's records after he knew that respondent wanted them.)

We are not completely convinced that Dane existed. Dane did not appear at the trial. Petitioners did not produce anyone other that John and Carol to testify as to Dane's existence. We suspect that he might be a "fudge factor", created to fill in gaps in explanations. Some may liken him to Harvey the rabbit, much talked about but never seen nor heard except by John and Carol. (see Vicknair v. Commissioner, T.C. Memo. 1990-434, slip op. at 19.)

On balance, we have concluded that it is more likely than not that Dane existed. We do not believe he played all the roles that John and Carol have testified to. In particular, we do not believe that John turned WRC over to Dane. In this regard, we accept the implied representations by John that he was

A. Association Status

Petitioners argue that WRC is a "business trust", taxable as a corporation. They contend that WRC has all six of the major characteristics which, Treasury Regulations state, are ordinarily found in corporations. Petitioners stress Carol's role in WRC as being sufficient to satisfy the requirement that WRC have associates.

Respondent maintains that the only relevant characteristics are "associates" and "business purpose", that there were no associates (focussing o Carol), and that no business purpose has been established.

We agree with respondent that Carol was not as associate and that

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and continued to be WRC' fiduciary.

WRC is not taxable as a corporation.

Section 7701(a)(3)[20] defines "corporation" to include "associations". A trust may be classified as an association (and thus may be taxable as a corporation) but only if it has more corporate characteristics than noncorporate characteristics. Morrissey v. Commissioner, 296 U.S. 344,356-357 (1935); Sec. 301.7701-2 (a)(3), Proced. & Admin. Regs.

Section 301.7701-2 (a)(1),

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[20] SEC. 7701. DEFINITIONS.

(a) When used in this title [i.e., title 26, the Internal Revenue Code], where not otherwise distinctly expressed or manifestly incompatible with the intent thereof--

* * *

(3) Corporation.--The term "corporation" includes associations, joint-stock companies, and insurance companies.

Proced. & Admin. Regs., lists the following six characteristics to be considered in determining whether an organization is to be classified as an association: (i) Associates, (ii) an objective to carry on business and divide the gains therefrom, (iii) continuity of life, (iv) centralization of management, (v) liability for corporate debts limited to corporate property, and (vi) free transferability of interest. Morrissey v. Commissioner, 296 U.S. at 356,359. In evaluating these elements, although "the use of corporate forms may furnish persuasive evidence of the existence of an association, the absence of particular forms, or of the usual terminology of corporations, cannot be regarded as

decisive." Morrissey v. Commissioner, 296 U.S. at 358; United States v. Davidson, 115 F.2d 799, 801 (CA6 1940); sec. 301.7701-4(b), Proced. & Admin. Regs.

The last four characteristics lasted above are common to both trusts and corporations, and thus are not helpful in distinguishing between the two types of entities. Bedell Trust v Commissioner, 86 T.C. 1207, 1217 (1986); Elm Street Realty Trust v. Commissioner, 76 T.C. 803, 809 (1981). Accordingly, we focus our inquiry on whether the first two characteristics ((i) associates, and (ii) an objective to carry on business nd divide the gains therefrom) are present in the instant cases. Sec. 301.7701-2(a)(2), Proced. & Admin. Regs. We consider

first the associates test.

In Morrissey v. Commissioner, 296 U.S. at 356, the Supreme Court laid down the rule that--

> 3. "Association" implies associates. It implies the entering into a joint enterprise, and, as the applicable regulation imports, an enterprise for the transaction of business."

The Supreme Court went on to state (296 U.S. at 358) that a trust may be classified as a corporation even if the beneficiaries do not have such control as is commonly exercised by stockholders and even if they do not hold meetings to elect representatives. See Hecht v. Malley, 265 U.S. 144 (1924).

In Elm Street Realty Trust v. Commissioner, this court held that beneficiaries with limited powers were not associates, stating as follows (76

T.C. at 814):

> The beneficiaries' role in creating a trust may provide an indication of a planned, common effort. Active participation in establishing the entity evinces a voluntary association for engaging in a joint endeavor. On the other hand, the lack of the current beneficiaries' role in the trust's creation does not mandate a finding that they are not "associates." * * * As to those cases where the beneficiaries have either not participated in the trust's creation, or affirmatively entered in to the enterprise (e.g., by way of a purchase of their beneficial interests) some further voluntary activity may be necessary on their part to satisfy the "associates" requirement * * * where nongrantor beneficiaries receive their beneficial interest gratuitously, without solicitation, it is doubtful that they can be considered associated together in a common enterprise in the absence of some further joint activity (or at least the potential therefor) vis-a-vis the trust.

In Bedell Trust v. Commissioner, supra, this Court held that the

beneficiaries of a testamentary trust were not "associates" because (1) they neither created nor contributed to the trust, (2) their interests in the trust were not transferable, and (3) only three out of ten of them participated as trustees in the trust's affairs. Thus, the Court determined that the trust was not as association taxable as a corporation.

Creation of Trust

The preamble to the Trust Instrument (set forth in our Findings of Fact, _supra_) shows John as the only person whose property is to go into WRC. The only property transferred into WRC at its creation was the Meditator toilet. The parties agree that John invented the Meditator toilet and neither side contends that

Carol had an interest in the Meditator toilet. Thus, Carol's initial 50 certificates of beneficial interest were not in exchange for her investment or contribution of property to WRC. Also, Carol's receipt of John's 50 certificates for $1, on the date WRC was created, does not mean that Carol "affirmatively entered into the enterprise" (Elm Street Realty Trust v. Commissioner, 76 T.C. at 814).

Transferability

Carol could not transfer her certificates without the trustee's approval, under the provisions of the Trust Instrument. The Trust Instrument also provides that the trust could be terminated or renewed beyond its stated 10 years at the

complete discretion of the trustee. Accordingly, Carol had neither control nor assurance of how long she would be locked into her ownership of the certificates.

Active Participation

Under the Trust Instrument, Carol was specifically denied (1) any authority to transact business for WRC, (2) any interest in WRC's property, (3) any right to a partition of WRC's property, and even (4) any right to an accounting during WRC's existence. Carol's role in WRC's operations was to keep the books for WRC.

At trial, Carol put it this way:

> Q. [Izen] Who made the decisions? Who had the final say so with what was going to be done with the property of Water Resource Control and the assignment rights that it had in

the toilet?

A. John Whitehouse.

Q. All right. Did you have any sort of input in the decisions that were made, business-wise?

A. No.

Q. Did Mr. Whitehouse consult you before they were made in any decisions?

A. Did he consult me about business decisions??

Q. Yes. The decisions --

A. No. He made his own business decisions. He's been doing that for a long time.

Accordingly, we conclude that Carol did not participate actively in WRC's creation or conduct.

Taking into account the elements described in Elm Street Realty and Bedell, it follows that Carol was not an "associate" and so WRC does not meet the "associates" test.

The absence of either associates or a business purpose will cause a trust to be classified as other than an association. Bedell Trust v. Commissioner, 86 T.C. at 1218. Accordingly, WRC does not qualify as an association taxable as a corporation under section 7701(a)(3).

We hold for respondent on this issue.[21]

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[21] We note that John might have created WRC as a corporation, but instead he chose to create WRC as a trust. WE note that John might have filed corporate income tax returns for WRC, but instead he chose to file fiduciary income tax returns (Forms 1041) for WRC. Thus, in arguing that WRC should be treated as an association taxable as a corporation, petitioners are arguing against the form of operation they chose and that they confirmed on tax returns. Respondent has not contended that petitioners should be precluded from challenging the correctness of petitioners' own choices, and so we do not consider that question. (In each

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of the cases we have cited on this issue, as well as each of the cases that either of the parties has cited on this issue, the taxpayer sought to defend the taxpayer's choice of the trust form and respondent argued for taxation as a corporation. In none of those cases did the taxpayer seek to repudiate its own choice of form.) See Halstead v. Commissioner, 296 F.2d 61, 62 (CA2 1961), affg. T.C. Memo. 1960-106; R.T. Smith, "Substance and Form: A Taxpayer's Right to Assert the Priority of Substance", 44 The Tax Lawyer 137 (Fall 1990). By the same token, petitioners have not contended that John's involvement with WRC is enough by itself to satisfy the "associates" test (See Hynes v. Commissioner, 74 T.C. 1266, 1279-1281 (1980). Under the circumstances, we decline to explore either of those possible approaches to the instant cases. See Estate of Fusz v. Commissioner, 46 T/C/ 214, 215 n.2 (1966).

Finally, we do not examine business purpose, the other necessary corporate characteristic. We note that, for 1980-, all of WRC's income was passive or derived from hundreds of securities transactions. Petitioners do not claim that in 1980 WRC was in the trade or business of investing. See Commissioner v. Groetzinger, 480 U.S. 23 (1087), especially that opinion's discussion

B. Grantor Trust Rules

Having concluded that WRC is subject to taxation as a trust rather than as a corporation, we next consider whether it is a grantor trust (secs. 671 et.seq.), and whether its income and expenses are directly taxable to John under section 671.

Respondent argues that John possessed such dominion and control over the corpus and income of WRC that WRC is subject to the grantor trust rules and John should be treated as WRC's owner.

Petitioners maintain that any control exercised by John over the trust corpus was consistent with the business purpose of WRC. Thus,

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of Snyder v. Commissioner, 295 U.S. 134 (1935), and Higgins v. Commissioner, 312 U.S. 212 (1941).

petitioners contend, the grantor trust provisions do not apply.

We agree with respondent.

Grantor

We begin by noting that the Trust Instrument states that Jenkins is the "Creator" of the trust while John is the "Investor Exchangor". Although the creator of a trust is usually the grantor of that trust, this classification results only because the creator is usually the person who transfers property to the trust.

In the instant case, John was the one who transferred property (the Meditator toilet), thereby creating the res of the trust. Jenkin's then appointed John the trustee of WRC. Except for the nature of the property

transferred to the trust, the instant cases are even stronger for respondent on this issue than what we faced in Bixby v. Commissioner, 58 T.C. 757, 789-791 (1972). Thus, we concluded that John (and not Jenkins) is the grantor of WRC, within the meaning of the grantor trust provisions.

If the grantor of a trust has any of the powers enumerated in sections 673 through 677, then, for income tax purposes, the grantor is treated as the owner of that portion of the trust over which the proscribed powers extend. Where the grantor is so treated, section 671[22] includes in

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[22] SEC. 671. TRUST INCOME, DEDUCTIONS, AND CREDITS ATTRIBUTABLE TO GRANTORS AND OTHERS AS SUBSTANTIAL OWNERS.

the grantor's income "those items of income, deductions, and credits * * *

Where it is specified in this subpart [subpart E of part I of subchapter J, relating to when grantors and others are treated as substantial owners of trusts] that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter [chapter 1, relating to normal taxes and surtaxes] in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust shall be subject to subparts A through D [general rules governing estates, trusts, and beneficiaries]. No items of a trust shall be concluded in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under section 61 (relating to definition of gross income) or any other provision of this title [title 26, the Internal revenue Code], except as specified in this subpart.

of he trust which are attributable to that portion of the trust to the extent that such items would be taken into account * * * in computing taxable income or credits * * * of an individual."

Adverse Party

Generally, and in the instant cases, we first consider whether the grantor may exercise a power without the consent of an adverse party, as defined in section 672[23]. Wesenberg

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[23] SEC. 672. DEFINITIONS AND RULES.

(a) Adverse Party.--For purposes of this subpart, the term "adverse party" means any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust. A person having a general power of appointment over the trust property shall be deemed to have a beneficial interest i the trust.

v. Commissioner, 69 T.C. 1005, 1012 (1978). An adverse party is any person with a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which the grantor possesses respecting the trust. A nonadverse party is anyone who is not an adverse party.

Ordinarily, a beneficiary is an adverse party. Phipps v. Commissioner, 137 F. 2d 141 (AC2 1942), affg. in part and revg. in part 47 B.T.A. 357 (1942). However, where the trustees have no obligation to make any payments to a beneficiary, the beneficiary does not have a

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(b) Nonadverse party.--For purposes of this subpart, the term "nonadverse party" means any person who is not an adverse party.

substantial interest, and thus is not an adverse party, Fulham v. Commissioner, 110 F. 2d 916 (CA1 1940), affg. 40 B.T.A. 48 (1939).

Section 166 of the Revenue Act of 1932 is the predecessor of section 676(a), and embodies what for out purposes is essentially the same concept of the circumstances under which a person would be regarded as having a substantial interest adverse to the grantor. In describing the policy of section 166 of the Revenue Act of 1932, the Circuit Court of Appeals for the First Circuit stated as follows (Fulham v. Commissioner, 110 f. 2d at 918):

> The evident policy of the Revenue Act is to tax the income to the grantor of a trust when he retains the substantial mastery over the corpus. Even though in form he lodges the power of

> revocation in someone other than himself, Section 166 is founded on the reasonable premise that the grantor still retains practical mastery, when this power is given to someone having no stake in the trust, or a stake so insubstantial that the holder of the power would not improbably be amenable to the grantor's wishes. This calls for a realistic appraisal.

See Chase National Bank v. Commissioner, 225 F. 2d 621, 627-628 (CA8 1955), affg. D.G. McDonald Trust v. Commissioner 19 T.C. 672, 690-692 (1953), applying the same approach in dealing with sections 166 and 167(a) of the Internal Revenue Code of 1939, the predecessors of sections 676(a) and 677(a).

As we put it more recently in Paxton v. Commissioner, 57 T.C. 627, 631 (1972), affd. 520 F.2d 923 (CA9 1975)--

> The question of adverse

> interest is essentially one of fact, which must be determined by considering in each case the particular interest created by the trust instrument and the relative size of that interest. Similarly, whether the particular interest, regardless of size, is of an adverse nature must be determined under the facts of each case.
>
> * * *

With the foregoing in mind, we consider whether Carol was an adverse party, within the meaning of section 672(a).

Carol was the sole beneficiary (Certificate Holder) of WRC, and John was the sole trustee. The Trust Instrument states that "Certificate Holders as such have absolutely no rights in the management of this Trust Organization, nor in the selection or replacement of its Trustees, nor control over them." The Trust Instrument gives to Carol the right

"to participate in all surplus and other distributions of net income as the Trustees from time to time may declare and pay out. This is an option, and not a duty." The Trust Instrument provides the "No Certificate Holder shall have any fight to a partition of the trust property or to an accounting during the continuance of the trust."

In case there is any doubt about the insubstantiality of Carol's interest, that is laid to rest by the specific authority given to the trustee to amend any part of the Trust Instrument except the provision protecting Certificate Holders from (1) assessments and (2) personal liability for any actions of the trust. Thus, even Carol's right to

distributions might be eliminated by John's unilateral action. Accordingly, we conclude that Carol was not as adverse party as defined in section 672. Thus, John wa free to exercise whatever powers he had over WRC without the consent of an adverse party.

Powers

John, as grantor, is treated as the owner of any portion of WRC as to which he has the power to dispose of the beneficial enjoyment of corpus or income (sec. 674(a)). or exercise certain administrative powers (sec 675), or revest title in himself (sec 676(a)), or distribute currently or hold for the future WRC income to himself or Carol (sec. 677(a)). All of those powers John had or could have

had by his essentially unfettered power to amend the Trust Instrument.

Based on these facts, we conclude that John possessed the requisite control over the corpus and income of WRC for him to be treated as the "owner" thereof under section 674 through 677. Accordingly, the income and expenses reported by WRC are includable under section 671 in computing petitioners' taxable income and credits.

We hold for respondent on this issue.[24]

III. Negligence Addition

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[24] Under these circumstances, we do not consider respondent's contention that the separate existence of WRC should be disregarded and WRC treated as merely a part of John's Whitehouse Engineering sole proprietorship.

Respondent maintains that part of petitioners' underpayment of tax for each of the taxable years 1979 and 1980 is due to negligence or intentional disregard of rules and regulations.

Petitioners argue that they acted prudently by consulting both an accountant and an attorney for both the 1979 and 1980 returns.

We agree with respondent.

Petitioners have the burden of proving respondent erred in determining that they are liable for additions to tax under section 6653(a)[25] for each of the years in

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[25] SEC. 6653. FAILURE TO PAY TAX.

(a) Negligence or Intentional Disregard of Rules and Regulations With Respect to Income or Gift Taxes.--If any part of any underpayment (as

issue. Bixby v. Commissioner, 58 t.C. at 791-792.

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defined in subsection (c)(1) of any tax imposed by subtitle A or by chapter 12 of subtitle B (relating to income taxes and gift taxes) is due to negligence or intentional disregard of rules and regulations (but without intent to defraud), there shall be added to the tax an amount equal to 5 percent of the underpayment.

[The subsequent amendments of this provision by sec. 101 of the Crude Oil Windfall Profit Tax Act of 1980 (Pub. L. 96-223, 94 Stat. 229, 252), by sec. 722 of the Economic Recovery Tax Act of 1981 (Pub. L. 97-34, 95 Stat. 172, 341) by sec. 107(a)(3) of the Technical Corrections Act of 1982 (Pub. L. 97-448, 96 Stat. 2365, 2391), by sec 1503 of the Tax Reform Act of 1986 (Pub L. 99-514, 100 Stat. 2085, 2742), and by sec. 1015(b) of the Technical and Miscellaneous Revenue Act of 1088 (Pub L. 100-647, 102 Stat. 3342, 3568), do not affect the instant cases.

As a result of sec. 7721(a) and 7721(c)(1) of the Omnibus Budget Reconciliation Act of 1989 (Pub. L. 101-239, 103 Stat. 2106, 2395, 2399), the revised negligence, etc., additions to tax now appears in sec. 6662, I.R.C. 1986.]

We believe that it is significant that neither the accountant nor the attorney was called as a witness. (Petitioners had listed their accountant s a witness on their pretrial memorandum). Nor was any documentary evidence provided, such as bills or correspondence with these professional advisors. See Wichita Terminal Elevator Co. v. Commissioner, 6 T.C. 1158, 1165 (1946), affd. 162 F.2d 513 (CA10 1947).

Even is they had appeared, we doubt they could have justified the asserted royalty payment to IBS followed almost immediately by the "loan" from IBS to WRC. During the years before the Court, funds were passed around between the WRC Bank Account the IBS Bank Account, the

Midas Bank account, and the Brokerage Account in a manner that makes it plain that the three accounts were merely alternate pockets for petitioners. We ar convinced that the deficiency attributable to the royalty deduction is due to negligence or intentional disregard of rules and regulations.

Similarly, petitioners have failed to substantiate the trade or business character of any of the claims of deductions (for 1979 and 1980) and investment credit (for 1079) on account of the Limousine. At best, they were negligent in failing to make and maintain business records; at worst, they intentionally disregarded rules and regulations in claiming the deductions and credit. The

deficiencies attributable to those items are due to negligence or intentional disregard of rules and regulations.

The claimed deductions of consulting fees were entirely unfounded (the 1980 claim being particularly egregious); the resulting deficiencies also are due to negligence or intentional disregard of rules and regulations.

Thus, we conclude that petitioners are liable for the addition to tax for negligence under sections 6653 (a) for both 1979 and 1980.

We hold for respondent on this issue.

To take account of the foregoing and concessions by respondent.

Decision will be entered under Rule 155 in docket No. 18690-83.

Decision will be entered for petitioner in docket No. 18689-83.

UNITED STATES TAX COURT

JOHN H. WHITEHOUSE and)
CAROL A. WHITEHOUSE,)
)
Petitioners,)
)
v.) Docket
) 18690-83
COMMISSIONER OF)
INTERNAL REVENUE,)
)
Respondent.)

DECISION

Pursuant to the opinion of the Court filed March 6, 1991, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

ORDERED and DECIDED: That there are statutory deficiencies in income tax due from the petitioners for the taxable years 1979 and 1980, in the amounts of $64,101.22 and $12,887.75, respectively; and

That there are additions to the tax due from the petitioners for the taxable years 1979 and 1980, under the provisions of I.R.C. 6653(a), in the amounts of $3,205.06 and $644.39, respectively.

Entered: Sep 9, 1991 (Signed) Herbert L. Chabot

CONTRACT AND DECLARATION OF TRUST FOR THE FORMATION OF WATER RESOURCE CONTROL

THIS CONTRACT AND DECLARATION OF TRUST IS EXECUTED IN THE UNITED STATES OF AMERICA, AND SHALL BE CONSTRUED UNDER ITS COMMON LAW.

PREAMBLE

This Contract and Declaration of Trust (the "Indenture") is made this 28th day of October, 1978, by and between James S. Jenkins, of Woodland Hills, California, a Creator of this Common Law Trust Organization, and the below named Investor/Exchangor. The Creator has offered, and hereby offers to bargain, or exchange, in trade, the

sum of One Dollar ($1.00) and all authorized Trust Certificate Units, for certain real and/or personal property of John H. Whitehouse of West Suffield, Connecticut, as investor/exchangor who, for the said sum and all One Hundred (100) Trust Certificate Units, the receipt and sufficiency of all of which is hereby acknowledged (which said investor considers to be full and adequate consideration for such exchange), accepts such offer and do hereby bargain, assign, convey, exchange, and deliver all that certain real and/or personal property of the investor/exchangor unto said Creator, who now temporarily takes and holds title thereto in the Trust Organization name, WATER RESOURCE

CONTROL, pursuant to the terms hereof.

The purport of this instrument is that these same assets, and all interest therein, will be promptly assigned and conveyed to a Board of Trustees, so as to constitute the corpus of the Pure Common Law Trust Organization (frequently called "Trust Organization"), hereby created and to begin forthwith, for the benefit of its certificate holders, with such assets to be held in fee simple by the trust organization (or by its trustee, if otherwise required), in trust, for the period(s) hereof. Its purposes are to provide for the growth and preservation of the corpus and the safe, logical and economical administration thereof by natural and/or artificial persons or entities

acting in a fiduciary capacity.

CHARACTER OF THE TRUST ORGANIZATION

It is hereby expressly declared that there is created a pure, common law form of trust, of the type commonly termed a business trust, and not a partnership, corporation or joint stock association.

This trust is hereby created as a separate, legal entity. None of the Certificate Holders as such shall ever have or possess any legal or equitable title in any of the properties or assets of the Trust Organization. Full title (both legal and equitable) to all its assets and properties is merged in the Board of Trustees. Title to assets shall be held, and properties conveyed, as herein

provided. Certificate Holders as such have absolutely no rights in the management of this Trust Organization, nor in the selection or replacement of its trustees, nor control over them.

NAME, DOMICILE AND OFFICES

The Trustees hereof, singly or collectively, shall be designated as the Board of Trustees of WATER RESOURCE CONTROL, in which name (or other assumed name) they may conduct any and all business, deal with any property, and sue or be sued, all as herein may be permitted.

Its principal domicile and place of business shall be in West Suffield, Connecticut, or elsewhere as designated by the Trustees with such branch offices or places of business

as they may establish.

DUTIES OF CREATOR: APPOINTMENT OF ORIGINAL TRUSTEES

Promptly upon completion of said exchange above made, the Creator shall forthwith constitute and appoint a qualified adult person or other entity as the first Trustee hereof, having an absolutely free choice of selection. Following acceptance of the position, the designee shall serve as a Trustee of this Trust Organization. The Creator shall promptly assign convey, and deliver all the concerned assets and properties to such Trustee, whereupon the Creator shall have absolutely no further duty or obligation to the Trust Organization; nor shall it and its appointed Trustee have any duty of obligation of any

kind to said Creator.

The first Trustee may independently appoint a second trustee hereof, and they in turn may appoint a third trustee.

CHARACTER, ISSUANCE, TRANSFER AND OWNERSHIP OF CERTIFICATES

This Trust Organization is authorized to issue One Hundred (100) Trust Units, each of equal value, to be evidenced by exchange to such persons, for such sums or other consideration, and on such terms, as they may deem expedient.

Trustees shall issue or cause to be issued to such investors, certificates in such form as the trustees may deem proper, evidencing the beneficial interests of such share owners. The certificates shall be

personal property and shall entitle the owners thereof to participate in all surplus and other distributions of net income as the Trustees from time to time may declare and pay out. This is an option, and not a duty. The Holders of record of Trust Certificates shall be entitled only to their proportionate shares of any such distributions, and of the assets upon dissolution as provided herein.

The only relationships of the Certificate Holders to the Trustees and to this Trust Organization, are those described herein and none other. There are to be no meetings of the Certificate Holders as such. Except as provided in this declaration of trust, no holder of a certificate evidencing ownership of an interest in

the trust shall have any authority, power or right whatsoever to transact any business for or on behalf of he trust, or the Trustees hereof, in connection with the trust property, or any part thereof, and shall have no interest in the specific property belonging to the trust, or in any part thereof, except the rights to receive the income and distributable funds arising therefrom as set forth herein.

The rights of Certificate Holders and of transferees and other persons becoming entitled to shares of the trust shall be subject to all the terms and conditions of this declaration of trust. No Certificate Holders shall have any right to a partition of the trust property or to an accounting during the continuance

of the trust.

With the prior approval of the Board of Trustees, Trust Units (and the Certificates representing the same) shall be transferable before the death or dissolution of the registered Holder thereof, by a simple assignment in writing, accompanied by surrender of such Certificate(s) to the Trustees or their agent, but no transfer shall be effective against the Trustees (even with actual or constructive notice), unless and until approved by them and a record of the new Certificate has been duly noted in the Minutes of the Trust Organization. On the transfer, surrender, or release thereof from the registered Holder, a new Certificate shall be issued to the designated transferee(s). In case of

a transfer of only part of the total units held, a new Certificate for the residue shall be issued to the transferor.

In case of loss or destruction of a Certificate of shares, a new one may be issued in its place, on such conditions as the Trustees may deem necessary and proper.

LIABILITIES OF CERTIFICATE HOLDERS

The Certificate Holders shall not be liable for any assessment, and the Trustees shall have no power to bind the Certificate Holders personally. All persons dealing with or having any claim against Trustees or any officer or agent of the trust

shall look only to the funds and property of the trust for the payment of any debt, claim, damage, judgment, or decree, or of any money or thing that may become due or payable in any way, whether founded on contract or tort, and the certificate holders shall not be personally or individually liable therefor. No amendment shall ever be made to this declaration of trust increasing or enlarging the liability of Certificate Holders, without the written consent of all the Certificate Holders.

It is not intended to create hereby any relation of partnership or of agency among the Trustees, or between the Trustees and the Certificate Holders or among the Certificate Holders, but the title to

every item of the property constituting the trust Certificate Holders, individually jointly, and severally, shall have no legal or equitable title, right or interest in or to any item thereof.

QUALIFICATIONS OF TRUSTEES

In order to serve, all Trustees (if a person) shall be above the age of eighteen (18) years and not declared to be of unsound mind or mentally ill, nor finally convicted of a felony grade offense. A Trustee holding such office shall be deemed to be sully qualified for all purposes, unless and until removed for cause as herein provided. A Trustee may be a person or other entity. Another trust

organization or a corporation are deemed to be such entities during the span of their existences. Each Trustee, before assuming such position, shall accept the appointment in writing, same to be filed among the Minutes of the Trust Organization.

The Trustees shall be not less than one in number and may be increased by he Trust Organization. The Boar of Trustees, may, by resolution made a part of the Minutes, provide for an order of succession of Trustees and/or interim Trustees, but no such designation shall be binding on the Trustees, who may engage or revoke any such designation at any time before actual investiture of a new Trustee.

In the event of a vacancy from

any cause or increase in number, the Trustees may appoint a successor or new Trustee by the unanimous concurrence of all remaining Trustees. Should the entire Board of Trustees become vacant, with no successors previously applied for, only then may a court of competent jurisdiction appoint a successor Trustee.

DEATH, RESIGNATION, INCAPACITY OR REMOVAL OF TRUSTEE

In the event of the death, resignation, incapacity or removal of a Trustee as herein provided, then such office shall be deemed vacant, and a designated successor or interim Trustee shall fill the vacancy as above authorized.

The work "incapacity" shall include (without limitation) the mental incompetency, incarceration or illness lasting more than ninety (90) days, the disqualification, or cessation of business of a person or entity acting as Trustee.

A Trustee may resign with or without notice, and also may be removed from office by a resolution of as least tow-thirds (2/3rds) of the entire Board of Trustees, whenever in their opinion an offending Trustee shall be disqualified or have other proper cause by the decision or order of any arbitrator(s) or of a Court of competent jurisdiction.

MEETINGS AND VOTING OF

TRUSTEES

By resolution, or otherwise, the Trustees may provide for regular meetings of the Board at stated intervals without notice. Special meetings may be called at any time for any two or more Trustees upon seven days written notice mailed or delivered to the Trustees, or may be held by unanimous waiver, by attendance of the Trustees at the meeting, or by their approval of the Minutes of such meeting.

At any meeting, a majority of the Trustees acting shall constitute a quorum for the conduct of business. Affirmative action may be had or taken only upon a majority vote of all the Trustees acting, whether present or absent, except that at special

meetings called for a stated purpose, a majority of the Trustees actually present may affirmatively act regarding such stated matter(s). Proxies shall never be allowed.

POWERS AND DUTIES OF TRUSTEES AND OFFICERS

The original Trustee and the Board thereof, for themselves and their successors, hereby accept the assignment and conveyance, in trust, upon the terms and conditions of this Indenture, and receipt for the delivery of all the assets and properties listed in Schedules A and B hereto, together with related supporting documents. They agree to conserve, build and improve upon the assets of the Trust Organization in such manner as may increase its value

and financial rating, exercising their best judgment and discretion, and in all other respects to administer their duties in good faith and in conformity with the provisions hereof. All funds received of paid into the treasury are, and shall become, part of the corpus of the Trust organization.

Trustees shall hold the legal title to all property at any time belonging to the Trust, and shall have absolute and exclusive control, management and disposition thereof, and absolute and exclusive power and control over the management and conduct of the businesses and affairs of the trust, free from any power of control on the part of the Certificate Holders.

Trustees may hold, manage, deal

with and dispose of the property and business of the trust in the same manner as if they were the absolute proprietors thereof, subject only to the specific limitations herein placed on their powers. The enumeration of powers contained herein shall not be construed as limiting in any way the general powers hereby conferred on Trustees. They shall have all powers necessary, convenient, or appropriate to the purposes and ends of this trust, and are authorized to take any action which they may deem proper to carry out such purposes.

Trustees shall have the powers, among others, to purchase or otherwise acquire property, patents, inventions, and to sell, exchange, lease, mortgage, pledge, or in any manner

dispose, encumber, improve, or deal with the property of the trust, or any part thereof or any interest therein, on such terms and for such consideration and purposes as they deem proper. Trustees may engage in business, manufacture and deal in goods, wares and merchandise, incur indebtedness, borrow or loan money with or without security, enter into contracts of all kinds, execute accept, discount, negotiate and deal in commercial paper and evidences of indebtedness, execute conveyances, mortgages, deeds of trust, leases and any other instrument in writing; they may invest and reinvest the trust funds; they may compromise or settle any suits, claims, or demands, or waive or release any rights, relating

to the trust property or business; they may appoint and employ officers, agents, attorneys and servants.

Trustees may sue and be sued and prosecute and defend any and all actions affecting the trust or its business or property, either in the name of the trust or in their own names; they may adopt and enforce such rules and regulations not inconsistent with the provisions of this instrument, as they may from time to time deem expedient.

COMPENSATION OF TRUSTEES

Trustees shall receive such compensation, regular or special, as they shall deem reasonable and proper. They shall fix the compensation, if any, of all officers and agents appointed by them.

APPLICATION OF TRUST FUNDS

Any act or thing done by Trustees, or by the officers of agents of the trust under authority from the Trustees, shall as to strangers dealing with such Trustees, officers or agents be conclusively deemed to be within the purposes of this trust and within the powers of the Trustees. No person dealing with Trustees of any of them, or with any officer or agent of the trust, shall be bound to see to the application by the latter of any funds or property passing into their hands or control.

LIABILITY OF TRUSTEES

No Trustee shall be liable for any act or omission whatsoever, of any other Trustee or of any officer, agent or servant of the trust. No Trustee

shall be liable for any negligence or error in judgment, or for any act or omission except for his own willful breach of trust. No Trustee shall be required to give any bond or surety to secure the performance of this trust.

Every act or thing done or omitted and every power exercised or obligation incurred by Trustees, or any of them in the administration of this trust or in connection with any business, property, or concern of the trust, whether ostensibly in their own names or in their trust capacity, shall be done, omitted, exercised, or incurred by them as Trustees and not as individuals. Every person contracting or dealing with Trustees or having any debt, claim, or judgment against them or any of them shall look

only to the funds and property of the trust for payment or satisfaction. No Trustee, officer, or agent of the trust shall ever be personally liable for, or on account of any contract, debt, tort, claim, damage, judgment or decree arising out of or preservation of, the trust property or the conduct of any business of the trust. A stipulation or notice to this effect may be inserted in any contract, order or other instrument made by the Trustees or their officers of agents, and on stationary used by them, but the omission thereof shall not be construed as a waiver of the foregoing provision and shall not render Trustees, officers, or agents, personally liable.

AMENDMENTS

This declaration of trust may be amended in any particular, except as regards the liability of the Certificate Holders, by the Trustees, by an instrument in writing, signed by the Trustees and setting out the amendment.

DURATION, TERMINATION AND CONTINUATION

This Trust Organization shall continue for a period of ten (10) years from date, unless sooner terminated. The Trustees may, in their unanimous discretion, because of a change in conditions, threatened depreciation in values, or for any other reason only to them deemed good and sufficient, liquidate and/or distribute the remaining assets as provided below, and close the Trust

Organization at an earlier date fixed by them. A Resolution of early termination shall be placed in the Minutes.

At any time before the above provided expiration date, the then Trustees, if they so desire and believe that said Trust Organization would be continued, may renew, and likewise before the expiration of any renewal period, may further renew, this Contract and Declaration of Trust for a like or shorter time period. A resolution of such renewal or further renewal shall be entered into the Minutes.

Upon termination of this Trust Organization from any cause, the Trustees may liquidate its properties and assets, if deemed preferable, by

disposing of all or part thereof for such amount and upon such terms as they deem prudent, at public or private sale(s). After discharging all proper taxes and legal obligation, they shall distribute the remaining proceeds and assets, in cash or in kind, among the then Certificate Holders in proportion to their respective interests. In lieu of this procedure, the Trustees may invest all the remaining assets in any other account, investment or business opportunity, on a pro rata basis, for, and in behalf of, the Certificate Holders entitled thereto. For these purposes, the Trustees shall continue to act until all such duties have been fully performed, whereupon this Trust Organization shall be finally closed.

In the event this instrument or other notice has been filed or recorded with a state officer or county official, they shall cause to be filed with the same public officials a notice that the Trust Organization has been terminated and closed. Thereupon, the Trustees shall be fully and finally discharged hereunder. Failure to file such notice, however, shall not otherwise affect the determination and closing.

The Trustees, or a majority of them in office, may at any time it seems desirable to do so, organize a corporation for the purpose among other things, of taking over the entire business and assets of the trust. In the event such course is decided on, the corporation shall be

organized in such form and under the laws of such state as may appear most desirable to the Trustees. On such incorporation, all of the assets of the trust shall be transferred to the corporation nd there shall be issued by the corporation its entire authorized common stock which shall be voting power. The stock shall be issued ratably to the Certificate Holders of the trust in proportion to the number of units held by each. All expenses incurred in organizing the corporation shall be paid from the funds of the trust.

IN WITNESS WHEREOF the Exchangor(s) and Creator hereof, for themselves, have hereunto et their hands and seals in token and recognition of the conveyance,

delivery and acceptance of property, assets, or other things and the obligations and duties as herein assigned as Trustees of said Business Trust Organization and assent to all stipulations herein as imposed and expressed.

John H. Whitehouse (seal)
Exchangor

James S. Jenkins (seal)
Creator

Carol H. Whitehouse
Exchangor

COUNTY OF)
)SS
STATE OF)

I, F. Michael Joseph Esq., a Notary Public, an officer authorized by law to administer oath, do hereby certify the
John H. Whitehouse and Carol H. Whitehouse Exchangors; and James S. Jenkins, Creator of
WATER RESOURCE CONTROL
A Non-Associated Business Trust
personally appeared before me this day and acknowledged that they signed,

sealed and delivered the above and foregoing Common Law Business Trust Organization Indenture for the uses and purposes therein set forth.

Dated this the 28th day of October, 1978.

J. Michael Joseph Esq.
Official signature

F. Michael Joseph Esq.
Notary Public in and for
Hampden County, Massachusetts.

MINUTES

OF

WATER RESOURCE CONTROL

1. The Creator approached John H. Whitehouse and Carol H. Whitehouse and offered to trade the 100 Trust Certificate Units contained in the Common Law Business Trust Organization Indenture and One Dollar ($1.00) for real and/or personal property, a list being attached hereto comprising of Schedule A and/or Schedule B.

After due consideration by all concerned, it was unanimously agreed to accept the proposed trade; the exchange was made. This exchange does not constitute a sale or gift.

John H. Whitehouse
Exchangor John H. Whitehouse

Carol H. Whitehouse
Exchangor Carol H. Whitehouse

James S. Jenkins 10-28-78
Creator

MINUTES

OF

WATER RESOURCE CONTROL

2. The Creator of this Declaration of Common Law Business Trust Organization hereby appoints John H Whitehouse, as first Trustee, under no obligations to said Trustee. As evidenced by the signature below, he hereby accepts the appointment together with the responsibilities pertaining thereto.

James L. Jenkins 10-28-78
Creator Date

John H. Whitehouse
Trustee Date

SCHEDULE A

THE FOLLOWING LISTS THE REAL AND/OR PERSONAL PROPERTY OF THIS TRUST ORGANIZATION:

1. The Meditator Toilet

This AGREEMENT made and entered into this Third day of November, 1978, by and between Water Resource Control having a place of business at West Suffield, Connecticut, (hereinafter called WRC), and International Business Services, Ltd. having a place of business at Nassau, Bahamas, (hereinafter called IBS):

WITNESSETH

Whereas, IBS is possessed of certain valuable information relating to certain know-how, trade secrets and technical information with respect to the research, development and experimental engineering on vacuum breaker valves, flush rim "micro sheeting" information; material information on vacuum breaker seats, design reports, research &

experimental sketches as listed and made part hereof as attachment "A"; as well as the research on the hydraulic cavitation problems associated with high performance pump designs; water sample test data in key locations and soil condition test data as relates to the permeability in key locations as listed and made part hereof as attachment "B" and world wide marketing assistance and particularly its caribbean basin market area contacts as listed and made part hereof as attachment "C";

Whereas, WRC is desirous of obtaining certain rights in and to said know-how, trade secrets and technical information possessed by IBS as it relates to the research development and experimental

engineering on vacuum breaker valves, flush rim "micro sheeting" information; material on vacuum breaker seats, design reports, research & experimental sketches as listed and made a part hereof as attachment "A", as well as research on the hydraulic cavitation problems associated with high performance pump designs; water sample test data in key locations and soil condition test data as relates to the permeability in key locations as listed and made a part thereof as attachment "B" and worldwide marketing assistance and particularly its Caribbean basin market area contacts as listed and made a part hereof s attachment "C"'

Now therefore, in consideration of the mutual promises herein

contained and for the other good and valuable consideration it is agreed between the parties as follows:

GRANT

As soon after the date hereof as WRC shall reasonably request IBS shall supply to WRC certain know-how, technical information, and trade secrets as well as any and all research & experimental data, design reports, research & experimental sketches as listed and made a part hereof as attachment "A". Additional un-numbered sketches and materials analysis reports are to be included as well as any sketches and work products and information now and during the term of this Agreement which relates to the development of WRC's product

line and other information which WRC may beneficially incorporate into its product line.

IBS is also willing to perform sales assistance in the Caribbean basin market as well as worldwide marketing assistance. Throughout the period of this Agreement, IBS will give WRC upon their request, the benefit of their advice and assistance in the practice and use of their methods and processes and any other information that may be reasonably necessary.

CONSIDERATION

ADVANCED ROYALTY

In consideration of the items listed herein and supplied by IBS, WRC agree to make the following Advanced Royalty payment to IBS:

a) WRC shall pay to IBS an

Advanced Royalty in the sum of Four Hundred ($400,000.) Thousand Dollars.

An amount equal to the Advanced Royalty as herein stated shall be deducted by WRC from the royalties due upon subsequent years production and sale of WRC's products. No additional royalties shall be paid to IBS until this provision has been satisfied.

ROYALTIES

In consideration of the items listed herein and supplied by IBS, WRC agrees to make the following royalty payments to IBS:

a) WRC shall pay to IBS a royalty in the amount of Three Quarters (3/4) of One (1%) percent on each full months production and sale of WRC product subject to the terms and conditions of this Agreement

which shall be payable on a monthly basis commencing with the first months serial production.

SALES COMMISSION

In consideration of the worldwide marketing assistance and contacts supplied by IBS, WRC agrees to make the following commission payments to IBS:

a) On any non OEM (original equipment manufacturer) or national account sales contracts IBS writes or initiates a commission of ten (10%) percent will be paid

b) As the Caribbean basin, South America and all islands associated therein are so vast other sales agents will have to be appointed. A Two (2%) percent override will be paid to IBS on all sales made by sid appointed

agents, a listing of which shall be provided to WRC upon request.

c) In the case of OEM account or a national account initiated by IBS< a sales commission of five (5%) percent shall be paid.

Commissions as identified in paragraphs a, b, & c above are to be based on net sales price, after trade discounts, but before cash discounts and with allowance for transportation of the products, for goods returned and delivered and paid during the preceding calendar months.

MISCELLANEOUS UNDERSTANDINGS

It is understood by both parties that theses drawings and sketches as referred to herein are not finished product drawings and sketches only basic research and development.

INTERFERENCE RESTRAINT

IBS covenants that neither it nor any person claiming through or under it will interfere with the use by WRC in the incorporation of WRC of the know-how, trade secrets, and technical information herein stated into its products or in the subsequent manufacture and sale of its products by WRC pursuant to the terms of this agreement.

CONFIDENTIAL RELATIONSHIP

All information supplied by or on behalf of IBS pursuant to this agreement shall be treated as confidential and shall be used solely to enable WRC and its bonafide subsidiaries and/or associated companies of WRC to incorporate said information into its products for

manufacture and sale of said products.

Trade secrets as relates to this agreement shall consist of any formula, pattern device, or compilation of information which is used in one business and which gives the user an opportunity to obtain an advantage over competitors.

RESTRICTIVE COVENANT

IBS shall not during the term of this agreement enter into this plumbing fixture market or any related market in competition with WRC in any domestic or foreign market either directly or indirectly through any subsidiaries, licensor and/or affiliated company.

ACCOUNTING

WRC agrees to keep true and accurate accounting records and shall

undertake to insure that its subsidiaries and/or associated companies keep similar records. Such records shall be available to IBS at all reasonable business hours. A report shall be rendered by a certified public accountant at the request of IBS at reasonable times during the term of this Agreement.

DEFAULT OF PAYMENTS

if WRC shall default in the payment of any royalty or commission payment or the making of any report hereunder or shall commit any breach of any covenant or agreement herein contained or shall made any false report of shall fail to remedy any such default or breach within thirty(30) days after written notice thereof by IBS< IBS may, at it option

cancel this Agreement and that such act shall not prejudice the right of IBS to recover any royalty or commission payment due at the time of such cancellation and shall not prejudice any cause of action or claim or IBS accrued or to accrue, on account of any breach or default made by WRC.

TERM OF AGREEMENT

This Agreement shall be for a period of five (5) years from the date hereof, and may be renewed from year to year thereafter unless sixty days (60) prior to the termination of any term year either party notifies the other of its intention not to renew. Said notification shall be in writing and be signed by the party.

NO PARTNERSHIP, JOINT VENTURE OR

AGENCY

Nothing herein contained shall be construed to constitute the parties hereto as continuing partners or as joint venturers, or as agent of the other.

ASSIGNMENT

All of the terms and provisions of the Agreement shall be binding upon and inure to the benefit of and be enforceable by the parties hereto, their respective successors and assigns.

WAIVER

A waiver of any breach of any provision of this Agreement shall not be construed as a waiver of any subsequent breach of the same or similar nature or of any other nature or kind.

FORCE MAJEURE

Neither party shall be liable to the other for failure or delay in meting any obligations hereunder due to strike, lockouts, or other labor disputes, war, fire, floods, riots, or other acts which re clearly beyond the reasonable control of the party involved.

ENTIRE AGREEMENT

This Agreement embodies the entire Agreement reached by the parties hereto with the subject matter hereof, and shall not be amended or modified except by an instrument in writing duly executed by the parties hereto.

END OF AGREEMENT

Neither party to this Agreement shall assign said Agreement as a whole or part without the written consent of the other, nor shall either party assign any monies due or to become due to it hereunder without the previous consent of the other party.

IN WITNESS WHEREOF, the parties hereto do hereby agree and have executed this Agreement, all as of the date set forth hereinabove.

INTERNATIONAL BUSINESS SERVICES
by Paul S. Dane, President
WATER RESOURCE CONTROL
BY John H. Whitehouse, Trustee

ATTACHMENT 'A'

It is understood by both parties that these drawings and sketches are not finished product drawings - only basic research and development.

Research and Experimental sketches and drawings:

VB R&D 17023 O
VB R&D 17029 L
VB R&D 17032 Q
VB R&D 17054 T
VBS R&D 19071 D
VBS R&D 19072 G
VBS R&D 19074 M
FR R&D 20021 G
FR R&D 20023 J
FR R&D 20024 N
FR R&D 20029 Q
FR R&D 20031 U

END OF ATTACHMENT 'A'.

INVENTION AND PATENT PURCHASE AGREEMENT

This Agreement made and entered into this twenty-eighth day of October, 1978, by and between the Meditator Company, a domestic unincorporated business trust organization domiciled in the State of California, of 6355 Topanga Canyon Boulevard, Woodland Hills, California 91367 (hereinafter referred to as "TMC"), and WATER RESOURCES CONTROL, a domestic unincorporated business trust organization domiciled in the commonwealth of Massachusetts, of Congamond Lake Entrance 3, P. O. Box 146, West Suffield, Connecticut 06093 (hereinafter referred to as "WRC").

WITNESSETH;

A. WRC has invented a new water

conservation toilet apparatus, hereinafter referred to as the "Meditator" toilet, which requires less than three cups of water to flush a toilet bowl with a typical amount of human waste (as compared with approximately six gallons required for the presently marketed toilets), and has successively constructed, demonstrated and tested this macerating toilet apparatus sufficient to cause the filing for a U. S. Patent and to engage in the manufacturing of Meditator toilets for public purchase of both the household model and thee recreational vehicle-marine model.

B. TMC earlier paid Ten Thousand Dollars ($10,000.00) to WRC during negotiations leading to this Agreement and TMC now desires to acquire and WRC

is willing to sell, under terms and conditions as specified herein, the U.S. Right Title and Interest in an to the invention of the Meditator toilet, including any and all U.S. Patents that may be filed for or issued thereon, including proprietary information which is useful and necessary in the manufacture of Meditator toilets.

C. TMC desires to establish a distributorship network in designated geographical areas throughout the United States by sublicensing others to sell Meditator toilets to the public, and to contract for the manufacture of Meditator toilets so covered under any U. S. Patent as outlined herein.

D The parties to this Agreement

contemplate that WRC will establish the manufacturing facility under exclusive license from TMC to manufacture Meditator toilets for TMC and/or for the sublicensed distributors established by TMC.

NOW THEREFORE, in consideration of the foregoing premises and the following covenants and conditions, the parties agree as follows:

1. GRANT;

WRC hereby assigns to TMC all right, title and interest in and to the invention of the Meditator toilet for the United States only, including the right to sub-license others, to make, use and sell Meditator toilets incorporating or made in accordance with or by use of the design, engineering and manufacturing data and

know-how of WRC or John H. Whitehouse or which is or may become covered by one or more U. S. Patent Rights of WRC. Concurrent with the signing of the Agreement, WRC agrees to file a U. S. Patent Application or Applications covering the Meditator toilet and agrees to file for such subsequent applications for Letters Patent in the United States for any improvements made by WRC relating to the Meditator toilet and to cause the assignment of such Letters Patent to TMC upon the same terms and conditions as set herein. WRC retains under its exclusive control any patent application and patents that it applies for anywhere outside of the United States for the Meditator toilet.

2. TRANSFER OF CONFIDENTIAL INFORMATION

In order to maintain that the highly confidential details of the Meditator toilet will be kept secret, WRC will not initially disclose to TMC, or personnel thereof, the exact details of the mechanism of the Meditator toilet. Since it is anticipated that WRC will manufacture Meditator toilets under license of and for TMC as outlined in a separate "Agreement to Manufacture" which is to be executed concurrent with the execution of this Agreement, and as specified in that "Agreement to Manufacture", it may occur that TMC may be required to license another manufacturer to satisfy the demands

for Meditator toilets by sub-licensed distributors of TMC due to the inability, failure to perform adequately or within the time specified in said "Agreement to Manufacture" by WRC and, further, should such a default occur, WRC hereby agrees to disclose to TMC or to another manufacturer so designated by TMC, complete information as to the operation, design, blueprints, drawings, parts, special parts requirements for non-standard parts and any other information of a proprietary nature which might be useful and necessary in the manufacture of Meditator toilets.

3. PATENT SEARCH AND PATENTABILITY

Upon the execution of this

Agreement WRC will provide TMC with one or more letters from a qualified Patent Attorney with respect to updating the patentability of the Meditator toilet.

4. BACK UP SOURCE OF INFORMATION

In order to assure that TMC will have full access to the confidential and proprietary information concerning the Meditator toilet, WRC agrees to deposit with an escrow agent concurrently with the execution of this agreement or within one day thereafter a complete description of the Meditator toilet, including manufacturing blueprints, patent Applications, drawings or the like of the parts thereof, special parts requirements and sources for nonstandard parts, and any proprietary

information it has which would be reasonably useful to the manufacturer of Meditator toilets. The escrow agent shall be one designated by the parties, who shall be instructed to hold all material in a secure place, and to give such material to TMC upon the death or serious incapacity of John H. Whitehouse of WRC or upon request of TMC after eighteen months following the date of this agreement, if WRC has no accomplished full manufacture of the toilet within eighteen months from the signing of this Agreement. Full manufacture shall be defined as a production level that will reasonably satisfy the demands of distributors.

5. INITIAL PAYMENT

TMC shall pay to WRC the sum

of ninety thousand dollars ($90,00) upon the execution of this Agreement. This sum is in addition to the Ten Thousand ($10,000) Dollars previously given by TMC to WRC during negotiations leading to this Agreement.

6. ADDITIONAL PAYMENTS

TMC expects to grant-distribution licenses to various third parties, giving them the license to sell Meditator toilets in certain geographical areas of the Untied States. TMC expects to sell such licenses for cash, Short Term Receivables and Long Term Receivables. Upon the sale of such distribution licenses by TMC, and in consideration of the assigning of the exclusive U. S. Patent Rights by WRC as outlined

herein, TMC shall pay to WRC within five (5) days receipt of same:

A. Twenty percent (20%) of the cash received as down payments or advance royalty payments upon the sale of distribution licenses and twenty percent (20%) of the cash received in the payment of the Short Term Receivables.

B. Thirty-five percent (35%) of any cash received by TMC within ten (10) years following the date of this Agreement where such cash received represents the payments of Long Term Receivables.

7. DISTRIBUTION LICENSE DESCRIPTION AND LIMITATIONS ON SALES

It is anticipated that any distribution license to be sold by TMC will comprise the right to sell

Meditator toilets within designated geographical areas of the United States based on a population of approximately four hundred thousand (400,000) people each, and that such a distribution license will be sold for an average minimum annual royalty price of fifty thousand ($50,000) dollars, and that the payments therefor may initially consist of Long Term Receivables payable out of royalties based on sales at a royalty rate of not less than ten dollars ($10.00) per Meditator toilet and for a period of ten (10) years. It is also anticipated that persons owning an interest in TMC may purchase one or more distribution licenses on the above terms.

Any distribution licenses for

areas of the United States not sold and paid for or purchased by TMC on or before June 30, 1079, shall automatically revert to WRC, who shall thereafter have the sole exclusive right to utilize or sell such distribution licenses for these areas of the United States and retain all funds received therefrom.

If any distribution license sold before June 30, 1079, is recovered by TMC by reason of default of the licensed distributor, then TMC shall have six (6) months after such recovery to purchase said license distributorship for itself in the name of TMC under the same terms and conditions as originally sold to the licensed distributor or to resell such license, and such resale shall be

considered a sale as provided under paragraph 6B. If TMC shall subsequently fail to resell such distribution licenses so defaulted, then said licenses shall become to property of WRC upon thirty (30) days notice to TMC of such default.

8. REPRESENTATIONS AND WARRANTIES OF WRC

WRC represents and warrants as follows:

a. That it has acquired the compete U.S. Right, Title and Interest in and to the Meditator toilet from the inventor, John H. Whitehouse and is now the sole owner of all title and interest in and to the invention covering the Meditator toilet;

b. That there are no Letters Patent or applications therefor in the

United states;

c. That the Meditator toilet does not to the best of the knowledge of WRC, infringe upon any other known Letters Patent heretofore issued in the United States or upon any other applications for Letters Patent of which it has notice or to the best of the Company's knowledge;

d. That there is no other person, firm or corporation having ny title or interest in the Meditator toilet or the Patent Application that will be filed thereon in the United States;

e. That there are no outstanding options, licenses or agreements of any kind relating to the Meditator toilet or the Patent application in the United States or

the manufacture, use or sale of the Meditator toilet or its improvement;

f. That it has the full power to sell, transfer and assign the inventions on the Meditator toilet and the patent application to be filed thereon to TMC;

g. That any new development or future modification in the invention made by WRC or John H. Whitehouse which relates to the Meditator toilet hall be assigned to TMC without any additional compensation to WRC by TMC;

h. That WERE will give first priority to supplying Meditator toilets to TMC;s licensees, with all shipments to be against letters of credit, sight drafts, C.O.D.'s or other methods of payment arrangements satisfactory to WRC.

9. ORIGINAL EQUIPMENT MANUFACTURERS AND NATIONAL ACCOUNTS

It is anticipated by the parties that certain distributors licensed by TMC may arrange for and/or assist in securing orders for Meditator toilets from large volume purchases (such as Federal, City or Municipal governments, hotel chain, school districts, recreational vehicle or marine manufacturers, national department stores or hardware stores, such as J. C. Pennys, Sears, or Ace hardware stores) where the size of the order or the nature of the distribution system of the purchaser is such as to extend beyond the geographic boundary lines of any single distributor licensee of TMC, and where such purchaser would

typically qualify to purchase Meditator toilets directly from the manufacturer as an Original Equipment Manufacturer ("OEM") or a National Account ("NA"). For the purposes of defining an OEM under this Agreement, the following criteria shall be used.

A. If in the normal course of business, the purchaser would likely qualify with a competitive manufacturer of a similar product as an OEM, or,

B. The Meditator toilets being purchased are to be used in conjunction with another manufactured product such as a travel trailer, motorhome or boat.

For purposes of defining a N.A. under this Agreement, the following criteria shall be used:

C. The volume of Meditator toilets purchased at any one time is greater that five hundred (500) units, and;

D. The distribution system of the purchaser of Meditator toilets extends beyond the boundaries of one or more state lines; or

E. In the event of a dispute as to what constitutes an OEM or an NO - the final decision shall be agreed to by WRC and Tmc.

In order to properly compensate any and all parties involved in securing OEM or NA accounts, the following "pooling" arrangement shall be followed:

F. The OEM or NA will be authorized to deal directly with WRC, TMC and any other authorized sub-

licensed manufacturer of Meditator toilets, with respect to negotiations of special needs (such as quantity, color, special tooling, shipping and/or delivery).

G. The pricing of large volume orders shall be arranged by TMC and WRC based upon the manufacturer's volume discount prices then in effect, but allowing for at least the minimum royalty per toilet to the licensed distributor as provided for in Section 7 of this Agreement. The pooling of the sales margin shall be as follows:

H. Where it can be reasonably supported that a licensed distributor solicited or assisted in generating an OEM or NA:

1. One sixth (1/6) of the sales margin will be paid to WRC

] 2. One sixth (1/6) of the sales margin will be paid to TMC.

3. One-third (1/3) to the licensed distributor who solicited or assisted in generating the OEM or NA and

4. One-third (1/3) to be distributed to all licensed distributors at the end of each calendar year on a pro rata basis as each respective distributor's sales volume relates to all other licensed distributors within the United States.

I. Where it cannot be reasonably supported that the OEM or NA was initially solicited or was generated by a licensed distributor:

1. One-third (1/3) of the sales margin will be paid to WRC.

2. One-third (1/3) of the sales

margin will be paid to TMC.

3. One-third (1/3) to be distributed to all licensed distributors at the end of each calendar year on a pro rata basis as each respective distributor's sales volume relates to all other licensed distributors within the United States.

Notwithstanding the above, the licensed distributor shall still be obligated to pay any royalty payments as provided in their respective distributorship Agreement.

10. FINDERS FEES

WRC hereby agrees to pay and shall hold TMC harmless from the payment of any Finders Fees which may relate to this Agreement.

11. FURTHER ASSISTANCE

Each of the parties hereto

shall, from time to time, at the request of the other, execute, acknowledge and deliver to the other party such further instruments and documents that are mutually agreed upon and as may be reasonably required to give full force and effect to the transactions contemplated by this Agreement.

12. ASSIGNMENTS

All of the terms and provisions of this Agreement shall be binding upon and inure to the benefit of and be enforceable by the parties hereto, their respective successors and assigns.

13. ENTIRE AGREEMENT

This Agreement embodies the entire Agreement reached by the parties hereto with the subject matter

hereof, and shall not be amended or modified except by an instrument i writing duly executed by the parties hereto

14. WAIVER

A waiver of any breach of any provision of this Agreement shall not be construed as a waiver of any subsequent breach of the same or similar nature or of any other nature or kind.

15. GOVERNING LAW

This Agreement has been negotiated and executed in the State of Massachusetts and shall be controlled, construed and enforced under the laws of the State of California irrespective of the place of the principal office of either party. The parties to this Agreement

hereby agree to abide by all the laws and regulations of the Federal, State an Local governments in all ares of the United States wherein each respective party operates.

16. INVALID PROVISIONS

In the event that any provisions of this Agreement shall be held to be invalid, the same shall not affect in any respect whatsoever the validity of the remainder of this Agreement.

17. PATENT INFRINGEMENT

Notwithstanding any of the provisions of this Agreement to the contrary, should the utilization of the Meditator toilet in the United States by adjudged on an unappealable decision rendered by a court of competent jurisdiction to be an

infringement of any valid claim of a patent not controlled by WRC, TMC shall be entitled to terminate this Agreement by one hundred eighty (180) days written notice to WRC of their election to do so, unless, within such period, WRC shall (a) obtain a license on behalf of TMC under the infringed patent, to use such license to the extent necessary to carry out the purposes and intent of this Agreement; (b) redesign the Meditator toilet at WRC's own cost, so as to avoid such infringement. WRC and TMC shall each pay fifty percent (50%) of the cost of such redesigning. In either of such cases, the notice of election shall be without further effect. Otherwise such notice shall be effective at the end of such one hundred eighty (180)

day period; and (c) if WRC becomes aware of infringement of the patent by third parties, them, within a reasonable time, WRC will notify TMC and TMC may then at its option:

(i) Institute litigation at its own expense against such third parties to enjoin the infringement, with any proceeds of the litigation being shared solely by TMC and WRC shall not share in such income. WRC shall assist in any way necessary in such litigation as may be reasonably beneficial for TMC.

(ii) TMC may give WRC the right to bring any action against such third party infringers to enjoin the infringement or to obtain a licenses from the third party infringers and TMC will cooperate in any way

necessary to assist WRC in such litigation. Such litigation under this subparagraph (ii) shall be at WRC's expense. Any proceeds from litigation instituted under this subparagraph (ii) shall accrue solely to WRC, and TMC shall not share in such income. If within thirty (30) days of notice by WRC to TMC of infringement by third parties, TMC does not institute litigation, then WRC may proceed under this subparagraph.

18. RECORDS

Both TMC and WRC agree to keep full accurate and complete books of account, records, data and memoranda respecting their said business in sufficient detail to enable the royalties payable hereunder

to be determined by the opposite party and further, TMC and WRC agree to and do hereby give to a certified public accountant designated by the opposite party, the privilege of examining its said books and records at all reasonable times and from time to time for the purpose of verifying the amounts provided for in this Agreement.

19. DEFAULT OF PAYMENTS

If TMC shall at any time default in the payment of any royalty payment or the making of any report hereunder or shall commit any breach of any covenant or agreement herein contained or shall make any false report or shall file to remedy any such default or breach within thirty (30) days after written notice thereof

by WRC, WRC may, at his option, cancel this Agreement and revoke the Assignment herein granted by notice in writing to such effect, that such act shall not prejudice the right of WRC to recover any royalty or other sums due at the time of such cancellation and shall not prejudice any cause of actions or claim of WRC accrued or to accrue on account of any breach or default made by TMC.

20. INSOLVENCY

If TMC shall become insolvent, or shall make an assignment for the benefit of creditors, or proceedings in voluntary or involuntary bankruptcy shall be instituted in behalf of or against TMC or a receiver or trustee of TMC;s property shall be appointed, the

Assignment herein granted shall terminate forthwith, and in case of any termination, all right, title and interest in and to the Assignment covered by this Agreement shall then and thereby forthwith revert to and become vested in WRC.

The failure to exercise any right or to terminate this Agreement in accordance with the article in the previous paragraph covering breaches, shall not be deemed a waiver of WRC's right so to do whereby TMC continues the breach or for any subsequent breach.

21. ARBITRATION

Any controversy or claim arising out of or relating to this Agreement or any modification or extension thereof shall be settled by

arbitration in accordance with the rules of the American Arbitration Association, and judgment upon the award rendered by the arbitrator (s) may be entered in any court having jurisdiction thereof.

22. NOTICE

Any notices, including address changes of the parties, by either party to the other may be made by first class letter. Unless changed in accordance with the provisions of this paragraph, the addresses of the parties shall be as follows:

The Meditator Company
6355 Topanga Canyon Boulevard
Suite 501
Woodland Hills, California
91367

Water Resources Control
P. O. Box 146
West Suffield, Connecticut
06093

23. END OF AGREEMENT

Neither party to this contract shall assign the contract as a whole or part without the written consent of the other, nor shall either party assign any monies due or to become due to him hereunder without the previous consent of the other party.

IN WITNESS WHEREOF, the parties hereto do hereby agree and have executed this document, all as of the date first set forth hereinabove.

THE MEDITATOR COMPANY
By: James S. Jenkins
Title: President

WATER RESOURCES CONTROL

By: John H. Whitehouse

Title: Pres.

Date: October 28, 1978

ENGINEERING, DESIGN AND CONSULTING CONTRACT

AGREEMENT dated this First day of January, 1979, by and between WHITEHOUSE ENGINEERING of West Suffield, State of Connecticut hereinafter called SELLER and WATER RESOURCE CONTROL, hereinafter called BUYER,

WITNESSETH:

WHEREAS, Seller has a place of business in West Suffield, Connecticut and

WHEREAS, Buyer is desirous of retaining the services of Seller in the designing and engineering of its products,

WHEREAS, Seller is willing to enter into this Agreement with respect to the use of his services upon the terms and conditions hereinafter set forth.

NOW THEREFORE, in consideration of the premises and of the mutual agreements hereinafter st forth, the parties hereto agree as follows:

1. Seller shall perform designing and engineering duties as the Buyer shall require.

2. Seller is willing to act as a consultant in the researching of plant location, plant design and layout, materials sourcing, manufacturing process, production start up, sales promotion of the Buyer and its products and whatever else is deemed appropriate by the Buyer.

3. Seller is willing to be consulted on all advertising and presentation.

4. Seller shall perform engineering and design services for the general good, advancement and improvement of WATER RESOURCE CONTROL and its products.

5. This Agreement shall commence on the First day of January, 1979, and shall continue for a period of twelve (12) months from that date.

6. In the event that the Buyer should, for any reason, wish to terminate this Agreement, it amy do so by giving thirty (30) days notice of its intention to terminate. The Seller shall have the same termination privilege.

7. In the performance of such

services as may be required under this Agreement, Sellers relationship to the Buyer shall be that of an independent contractor and not an employee of WATER RESOURCE CONTROL. The Buyer shall have no liability to Seller whatsoever on account of this Agreement, except as provided in the following paragraphs as FEES.

8. In consideration of Seller being permitted to work on the premises of Buyer, Seller will waive any claims for injury to himself and/or damage or loss to Sellers property that may arise out of or be caused by any acto or failure to act, whether negligent or otherwise, of the Buyer, its officers, or employees while on the premises of Buyer, excepting, however, injuries, loss or

damage resulting from the willful or intentional acts to cause the same. Seller will also release and waive any claims of liability for personal injury or property damage sustained by Seller while performing work under contract with WATER RESOURCE CONTROL buy on premises not owned by WATER RESOURCE CONTROL.

9. With respect to any other materials or services to be provided by Seller in accordance with the terms and conditions of this Agreement, the Buyer shall not be obligated to reimburse Seller for expenses incurred by Seller in performance of this Agreement in excess of the amounts actually paid for by Seller unless the Buyer shall have authorized such additional expenses in writing,

anything else appearing elsewhere herein to the contrary, notwithstanding.

10. It is understood that the total liability of WATER RESOURCE CONTROL for compensation of all services under this Agreement shall not exceed Fifty Thousand ($50,000) Dollars without the prior written consent of the Buyer. All invoices for services rendered must be submitted to the Buyer at the address below:

WATER RESOURCE CONTROL
535 ENTRANCE NUMBER THREE
WEST SUFFIELD, CONNECTICUT
06093

11. All inventions, designs and devices created by Seller during the term of this Agreement shall be the

property of the Buyer. Seller shall make such assignments or sign any papers or documents necessary to effectuate the acquisition of such inventions, designs or engineering devices by the Buyer. Inventions, designs and engineering devices partially completed during the term of this Agreement shall be the property of the Buyer.

12. In no event is a new product which is under the supervision of Seller to be put into production until Seller give his written consent thereto. The purpose for this condition is so that a product that has not been properly tooled and fully developed will not be rushed onto the market prematurely to the detriment of the Buyer and the personal reputation

of the Seller.

13. Upon the termination of this Agreement, Seller shall have the right to compete in the same business with the Buyer. It is understood that there shall be no covenant implied or expressed against competition on termination of this Agreement.

14. Seller is retained by the Buyer only for the purposes and to the extent set forth in this Agreement, and his relation to the Buyer during the period or periods of his service hereunder, by that of an independent contractor, and he shall be free to dispose of such portion of his entire time as he is not obligated to devote hereunder to the Buyer in such manner as he sees fit and to such persons, firms, or corporations as he deems

advisable. Seller shall not be considered under the provisions of this Agreement or otherwise as having an employee status or as being entitled to participate in any plans, arrangement, or distributions by the Buyer pertaining to or in connection with any pension, stock, bonus, profit-sharing, or similar benefits for their regular employees.

Signed and Sealed this 2nd day of January 1979.

WATER RESOURCE CONTROL by:

John H. Whitehouse, trustee

WHITEHOUSE ENGINEERING by:

John H. Whitehouse, president.

ENGINEERING, DESIGN AND CONSULTING CONTRACT

AGREEMENT dated this First day of January, 1980, by and between WHITEHOUSE ENGINEERING of West Suffield, State of Connecticut hereinafter called SELLER and WATER RESOURCE CONTROL, hereinafter called BUYER,

WITNESSETH:

WHEREAS, Seller has a place of business in West Suffield, Connecticut and

WHEREAS, Buyer is desirous of retaining the services of Seller in the designing and engineering of its products,

WHEREAS, Seller is willing to enter into this Agreement with respect to the use of his services upon the terms and conditions hereinafter set forth.

NOW THEREFORE, in consideration of the premises and of the mutual agreements hereinafter st forth, the parties hereto agree as follows:

1. Seller shall perform designing and engineering duties as the Buyer shall require.

2. Seller is willing to act as a consultant in the researching of plant location, plant design and layout, materials sourcing, manufacturing process, production start up, sales promotion of the Buyer and its products and whatever else is deemed appropriate by the Buyer.

3. Seller is willing to be consulted on all advertising and presentation.

4. Seller shall perform engineering and design services for the general good, advancement and improvement of WATER RESOURCE CONTROL and its products.

5. This Agreement shall commence on the First day of January, 1980, and shall continue for a period of twelve (12) months from that date.

6. In the event that the Buyer should, for any reason, wish to terminate this Agreement, it amy do so by giving thirty (30) days notice of its intention to terminate. The Seller shall have the same termination privilege.

7. In the performance of such

services as may be required under this Agreement, Sellers relationship to the Buyer shall be that of an independent contractor and not an employee of WATER RESOURCE CONTROL. The Buyer shall have no liability to Seller whatsoever on account of this Agreement, except as provided in the following paragraphs as FEES.

8. In consideration of Seller being permitted to work on the premises of Buyer, Seller will waive any claims for injury to himself and/or damage or loss to Sellers property that may arise out of or be caused by any acto or failure to act, whether negligent or otherwise, of the Buyer, its officers, or employees, while on the premises of Buyer, excepting, however, injuries, loss or

damage resulting from the willful or intentional acts to cause the same. Seller will also release and waive any claims of liability for personal injury or property damage sustained by Seller while performing work under contract with WATER RESOURCE CONTROL buy on premises not owned by WATER RESOURCE CONTROL.

9. With respect to any other materials or services to be provided by Seller in accordance with the terms and conditions of this Agreement, the Buyer shall not be obligated to reimburse Seller for expenses incurred by Seller in performance of this Agreement in excess of the amounts actually paid for by Seller unless the Buyer shall have authorized such additional expenses in writing,

anything else appearing elsewhere herein to the contrary, notwithstanding.

10. It is understood that the total liability of WATER RESOURCE CONTROL for compensation of all services under this Agreement shall not exceed Sixty Thousand ($60,000) Dollars without the prior written consent of the Buyer. All invoices for services rendered must be submitted to the Buyer at the address below:

WATER RESOURCE CONTROL
535 ENTRANCE NUMBER THREE
WEST SUFFIELD, CONNECTICUT
06093

11. All inventions, designs and devices created by Seller during the term of this Agreement shall be the

property of the Buyer. Seller shall make such assignments or sign any papers or documents necessary to effectuate the acquisition of such inventions, designs or engineering devices by the Buyer. Inventions, designs and engineering devices partially completed during the term of this Agreement shall be the property of the Buyer.

12. In no event is a new product which is under the supervision of Seller to be put into production until Seller give his written consent thereto. The purpose for this condition is so that a product that has not been properly tooled and fully developed will not be rushed onto the market prematurely to the detriment of the Buyer and the personal reputation

of the Seller.

13. Upon the termination of this Agreement, Seller shall have the right to compete in the same business with the Buyer. It is understood that there shall be no covenant implied or expressed against competition on termination of this Agreement.

14. Seller is retained by the Buyer only for the purposes and to the extent set forth in this Agreement, and his relation to the Buyer during the period or periods of his service hereunder, by that of an independent contractor, and he shall be free to dispose of such portion of his entire time as he is not obligated to devote hereunder to the Buyer in such manner as he sees fit and to such persons, firms, or corporations as he deems

advisable. Seller shall not be considered under the provisions of this Agreement or otherwise as having an employee status or as being entitled to participate in any plans, arrangement, or distributions by the Buyer pertaining to or in connection with any pension, stock, bonus, profit-sharing, or similar benefits for their regular employees.

Signed and Sealed this 2nd day of January 1980.

WATER RESOURCE CONTROL by:

John H. Whitehouse, trustee

WHITEHOUSE ENGINEERING by:

John H. Whitehouse, president.

AGREEMENT TO MANUFACTURE

This Agreement made and entered into this day of October, 1978, by and between The Meditator Company, a domestic unincorporated business trust organization domiciled in the State of California, of 6355 Topanga Canyon Boulevard, Woodland Hills, California 91367 (hereinafter referred to a "TMC"), and Water Resources Control, a domestic unincorporated business trust organization domiciled in the State of Congamond Lakes, Entrance #3, P.O. Box 146, West Suffield, Connecticut 06093 (hereinafter referred to as "WRC").

WITNESSETH;

A. TMC has acquired the U.S. right, title and interest in and to the

invention of a certain new, water conservation, macerating toilet apparatus herein after referred to as the "Meditator" toilet and desires to establish an exclusive manufacturing arrangement with WRC to manufacture said Meditator toilets on behalf of TMC and/or its appointed sub-licensed distributors in various geographic ares of the Unit States.

B. WRC, through John H. Whitehouse, has invented and successfully constructed, demonstrated and tested the Meditator toilet, and, after assigning the U.S. right, title and interest in and to this " toilet to TMC as outlined in a separate "Invention and Patent Purchase Agreement: which has been executed concurrently with this Agreement, now

desires to become the exclusive manufacturer on behalf of TMC and/or the sub-licensed distributors appointed by TMC in the United States.

C. WRC has demonstrated the capability to perform this undertaking sufficient to cause TMC to enter into this exclusive manufacturing agreement.

D. WRC and TMC have substantial common interests and mutual involvements in causing the Meditator toilet to be manufactured in sufficient quantity which will provide adequate numbers of Meditator toilets to be sold by the numerous sub-licensed distributors of TMC throughout the U. S. so that said distributors will be capable of paying the agreed upon royalty amounts, for

which they are obligated to pay under a separate "Distributors Agreement" with TMC, and, in which royalty payments WRC has a substantial portion fie them by TMC>

1. GRANT:

TMC hereby, grants to WRC the exclusive U.S. manufacturing rights only in and to the Meditator toilet, subject to the terms and conditions as outlined herein, for both the household model(s) and the recreational vehicle - marine model(s), to be built of durable parts and quality workmanship, according to and specified in the manufacturing blueprints, drawings and patent application now in the sole possession of WRC, or patent or patents yet to be issued by the U.S. patent office.

2. TERM OF AGREEMENT:

Unless mutually agreed to the contrary by written consent of the parties to this Agreement, or, unless this Agreement is breached by WRC as provided herein, the term of this Agreement shall be 10 years from the date of this signing, with automatic 5 year renewal extensions of this Agreement unless specifically agreed to the contrary by the parties.

Any changes or modifications as may be mutually agreed upon by the parties from time to time during the life of this Agreement shall be added hereto by written amendment.

3. LOCATION OF MANUFACTURER:

WRC shall be free to select that location of the manufacturing facility(ies) as may best suit the

needs and requirements of WRC as to manufacturer of Meditator toilets, and which will still satisfy the demands for toilets by the various licensed distributors and WRC shall be free to select and sublicense other manufacturers to assist WRC in the meeting the demand for Meditator toilets. The initial manufacturing facility is anticipated to be in the state of Florida.

4. COMMENCEMENT OF MANUFACTURING:

Upon the completion of the sale of initial sub-licensed distributors by TMC, which is anticipated to be completed by November 30, 1078, WRC shall commence with the establishing of the plant, equipment, parts, personnel, and all

other items required to carry out the successful "setting up" of a manufacturing facility so that Meditator toilets will be able to be produced in full production "start up" cycle sufficient to meet the demand for Meditator toilets by the licensed distributors, and shall do so within 12 months of the date of this Agreement, unless provided to the contrary within this Agreement. WRC shall use their "best efforts: to cause same to occur, and shall be solely responsible for any and all costs related thereto, including both initial and ongoing expenses of both plant, equipment, parts, and labor. TMC shall bear no financial responsibility with respect to WRC;s financial obligations under this

Agreement except as provided in the separate "Invention and Patent Purchase Agreement" concurrently executed.

5. GRACE PERIOD:

Notwithstanding the preceding paragraph, TMC shall allow if so required by WRC, up to an additional sic (6) months "grace period" or extension of time to paragraph 4, in the event that WRC an demonstrate that a reasonable effort has been made during the 12 months subsequent to this Agreement to establish the agreed upon level of production, and further, that the extension of time up to an additional six (6) months grace period will likely allow for sufficient time for WRC to complete a full start up of production cycle ample to meet the

demands of the licensed distributors of TMC for Meditator toilets.

6. BEST EFFORTS:

WRC shall use its best efforts to cause the following to occur in the shortest time period as is reasonably possible:

A. Assemble an advertising or sales brochure(s) reflecting the Meditator toilet model(s), features, specifications, prices and order information on behalf of the licensed distributors.

B. Engage in national advertising via television, radio, magazine and newspapers to gain public acceptance and awareness of the new Meditator toilet and its features.

C. Obtain federal, sate, and local environmental regulation and

industry approval of the Meditator toilet(s) for both home and recreational - marine use if such approval is necessary.

D. Assemble a technical manual pertaining to the various aspects of the Meditator toilet(s) on behalf of both the licensed distributors and their purchasers as would be supplied by other manufacturers of similar products to their dealers and distributors.

E. Establish a service policy for repair of defective Meditator toilets so manufactured by WRC.

7. PROTECTION OF CONFIDENTIAL INFORMATION:

Of primary importance to the success of this endeavor is the patent

protection afforded the novel features and the proprietary information relating to the Meditaotr toilet as it pertains to the present general state of the art of other toilets being manufactured and marketed. WRC hereby agrees to hold all such confidential information secret, and shall take every reasonable precaution to see that same is not stolen, destroyed, copied or lost, including but not limited to: plans, prints, drawings, blue prints, patents or patent application, sketches, engineering know-how, special parts requirements and source or sources for non-standard parts and any other proprietary information which might be reasonably useful to a manufacturer of toilets, and shall take every precaution to

keep such information confidential and from becoming known to any person or company who might use such proprietary information in a competitive manner to the determent of TMC and/or its' licensed distributors or WRC, during the term of this Agreement. If the Agreement is terminated for cause by TMC as specified in paragraph 4 as specified herein, WRC agrees to furnish TMC with all of said proprietary information to TMC immediately open demand so that TMC might carry out its obligation without jeopardy, to the various sub-licensed distributors as to providing said distributors with a competent manufacturer or manufacturers of Meditator toilets.

8. PRICING:

It is anticipated that the pricing of the Meditator toilets manufactured under this Agreement will be within the middle to upper middle range of the existing, conventional toilet manufacturers as to the suggested "retail price", but that WRC will be free to set the manufacturers price so as to allow for a reasonable manufacturers; profit, taking into account:

A. The obligations of WRC under this Agreement, such as national advertising, etc.

B. The supply-demand relationship in the open market where the sub-licensed distributors of TMC must compete freely but still allow for ample margin for said distributors to meet their royalty obligations to

TMC, in which WRC has a substantial interest and,

C. The similar price as might be charged by a competitive manufacturer of a similar product.

9. TERMINATION OF AGREEMENT:

TMC may terminate this Agreement for any of the following causes:

A. Failure of WRC to provide TMC with the level of production of Meditator toilets as specified herein.

B. Failure of WRC to take all reasonable and necessary precautions in maintaining the secrecy of the proprietary information herein before mentioned.

C. Failure of WRC to keep accurate books, records, and accounts pertaining to delivery of Meditator

toilets

D. Insolvency or bankruptcy by WRC, whether voluntary or involuntary.

E. The sale of Meditator toilets within the United States by WRC other than to TMC and/or the licensed distributors of TMC except as provided in this Agreement or the "Invention and Patent Purchase Agreement: executed concurrently.

F. Death or serious incapacity of John H. Whitehouse and where a comparable replacement or replacements are not adequately provided for sufficient for WRC to carry out the agreed upon obligations herein contained.

G. A material breach of this Agreement.

H. Failure to provide quality workmanship or durable parts based on generally accepted industry standards.

I. Failure to make all reasonable and diligent efforts to meet all delivery and production deadlines.

J. Failure to obtain the express written consent of TMC prior to the assignment of the Agreement to any third party.

10. PRODUCTION LEVEL:

WRC shall use its best efforts to anticipate the demands of TMC and the sub-licensed distributors of TMC for Meditator toilets, and shall use its best efforts to meet such demands by gearing its production level to coincide with the agreed upon

delivery dates, quantities, models, colors, etc. as may be arranged or ordered from time to time during the term of this Agreement.

11. NATIONAL ACCOUNTS AND ORIGINAL EQUIPMENT MANUFACTURERS:

WRC and TMC shall both use their best efforts to develop National Accounts and Original Equipment Manufacturers as described in the :Invention and Patent Purchase Agreement" paragraph 9, pages 6 through 8, executed concurrently and by reference hereby agree to the terms and conditions pertaining thereto.

12. FIRST PRIORITY AND PAYMENT OF GOODS:

WRC will give first priority to supplying Meditator toilets to the sub-licensed distributors of TMC, and

all shipments to said distributors are to be against acceptable letters of credit, sight drafts, COD's or other methods of payment arrangements satisfactory to WRC.

13. FINDERS FEES:

WRC hereby agrees to pay, and shall hold TMC harmless from, any finders fees which may relate to this Agreement.

14. BOOKS AND RECORDS:

Both TMC and WRC agree to keep full accurate and complete books of account, records, data and memoranda respecting their said business in sufficient detail to enable the royalties payable hereunder to be determined by the opposite party and further, TMC and WRC agree to and do hereby give to a certified public

accountant designated by the opposite party, the privilege of examining its sid books and records at all reasonable times and from time to time for the purpose of verifying the amounts provided for in this Agreement.

15. FURTHER ASSISTANCE:

Each of the parties hereto shall, from time to time, at the request of the other, execute, acknowledge and deliver to the other party such further instruments, and documents that are mutually agreed upon and as may be reasonably required to give full force and effect to the transactions contemplated by this Agreement.

16. ASSIGNMENT:

All of the terms and

provisions of this Agreement shall be binding upon and inure to the benefit of and be enforceable be the parties hereto, their respective successors and assigns.

17. ENTIRE AGREEMENT:

This Agreement embodies the entire Agreement reached by the parties hereto with the subject matter hereof, and shall not be amended or modified except by an instrument in writing duly executed by the parties hereto.

18. WAIVER:

A waiver of any breach of any provision of this Agreement shall not be construed as a waiver of any subsequent breach of the same or similar nature or of any other nature or kind.

19. GOVERNING LAW:

This Agreement has been negotiated and executed in the State of Massachusetts and shall be controlled, construed and enforced under the laws of the State of California irrespective of the place of the principal office of either party. The parties to this Agreement hereby agree to abide by all the laws and regulations of the Federal, State, and Local governments in all areas of the United States wherein each respective party operates.

20. INVALID PROVISIONS:

In the event that any provisions of this Agreement shall be held to be invalid, the same shall not affect in any respect whatsoever the validity of the remainder of this

Agreement.

21. FORCE MAJEURE:

Neither party shall be liable to the other for failure or delay in meeting any obligations hereunder due to strikes, lockouts, or other labor disputes, war fire, floods, riots, or other acts which are clearly beyond the reasonable control of the party involved.

2. ARBITRATION:

Any controversy or claim arising out of or relating to this Agreement or any modification or extension thereof shall be settled by arbitration in accordance with the rules of the American Arbitration Association, and judgment upon the award rendered by the arbitrator(s) may be entered in any court having

jurisdiction thereof.

23. NOTICE:

Any notices, including address changes of the parties, by either party to the other may be made by first class letter. Unless changed in accordance with the provisions of this paragraph, the addresses of the parties shall be as follows:

The Meditator Company
6355 Topanga Canyon Boulevard
Suite 501
Woodland Hills, California
91367

Water Resource Control
P. O. Box 146
West Suffield, Connecticut
06093

24. END OF AGREEMENT:

Neither party to this contract shall assign the contract as a whole or part without the written consent of the other, now shall either party assign any monies due or to

become due to him hereunder without the previous consent of the other party.

IN WITNESS WHEREOF, the parties hereto do hereby agree and have executed this document, all as of the date first set forth hereinabove.

THE MEDITATOR COMPANY

By: James S. Jenkins
Title: President

WATER RESOURCE CONTROL

By: John H. Whitehouse
Title: President

DATE: October 28, 1978